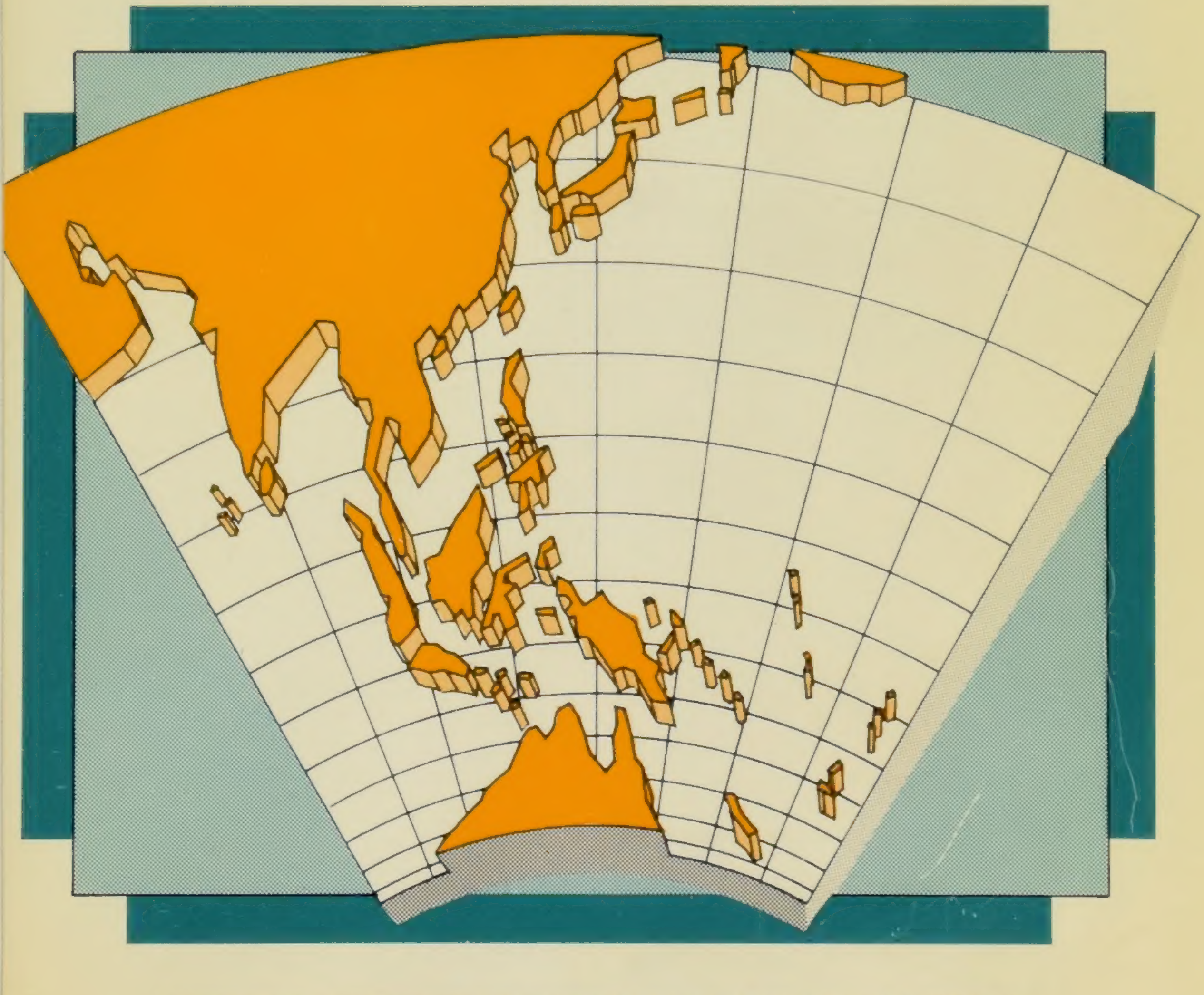
UNITED NATIONS

SERVICES IN ASIA AND THE PACIFIC

Selected Papers

Volume Two



UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

UNITED NATIONS DEVELOPMENT PROGRAMME

UNCTAD/ITP/51(Vol.II)

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT
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SERVICES IN ASIA AND THE PACIFIC: SELECTED PAPERS

Volume Two

UNCTAD/UNDP TECHNICAL ASSISTANCE PROJECT
FOR SUPPORT TO ASIA-PACIFIC DEVELOPING COUNTRIES
IN MULTILATERAL TRADE NEGOTIATIONS

UNITED NATIONS

New York, 1991

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Explanatory Notes

- References in the text and tables to "countries" are to countries, territories or areas as appropriate.
- The term "dollar" ($) refers to United States dollars, unless otherwise stated.
- The term "billion" signifies 1,000 million.
- Annual rates of growth and change refer to compound rates.
- Exports are valued f.o.b. and imports c.i.f., unless otherwise specified.
- Use of a hyphen (-) between representing years, e.g. 1965-1966, signifies the full period involved, including the initial and final years.
- An oblique stroke (/) between two years, e.g. 1980/81, signifies a fiscal or crop year.
- A dash (-) or a zero sign (0) indicates that the amount is nil or negligible.
- A plus sign (+) before a figure indicates an increase; a minus sign (-) before a figure indicates a decrease.
- The sign "na" stands for "not available".
- Details and percentages do not necessarily add up to totals, owing to rounding.

Abbreviations

ASEAN	Association of South East Asian Nations
BOP	balance of payments
BPM	*Balance-of-Payments Manual*
C & F	cost and freight
CCITT	Consultative Committee for Telegraph and Telephone
c.i.f.	cost, insurance and freight
CITIC	China International Trust and Investment Corporation
CRS	computerized reservation system
EC	European Community
EDB	Economic Development Board
EDI	electronic data interchange
EEC	European Economic Community
EPA	Economic Planning Agency
ESCAP	Economic and Social Commission for Asia and the Pacific
FDI	foreign direct investment
f.o.b.	free on board
GATT	General Agreement on Tariffs and Trade
GDP	gross domestic product
GNP	gross national product
GNS	Group of Negotiations on Services
IATA	International Air Transport Association
ILO	International Labour Organization
IMF	International Monetary Fund
ISDN	integrated services digital network
ITU	International Telecommunication Union
LNG	liquified natural gas
MFN	most favoured nation
MISC	Malaysian International Shipping Corporation Berhad
MITI	Ministry of International Trade and Industry

MTNs	multilateral trade negotiations
MTNC	manufacturing transnational corporation
NIT	new information technology
NRCC	non-resident controlled company
OECD	Organisation for Economic Co-operation and Development
R & D	research and development
RBP	restrictive business practice
SEACEN	South-East Asia Central Bank and Monetary Authorities
SCI	Shipping Corporation of India
SCICI	Shipping Credit Investment Company of India
SDFC	Shipping Development Fund Committee
SII	Structural Impediment Initiative
SNA	System of National Accounts
STNC	service transnational corporation
TNC	transnational corporation
TRIMs	trade-related investment measures
TRIPs	trade-related aspects of intellectual property rights
UNCTAD	United Nations Conference on Trade and Development
UNCTC	United Nations Centre on Transnational Corporations
UNDP	United Nations Development Programme
UNSO	United Nations Statistical Office

FOREWORD

The present publication constitutes the second volume of *Services in Asia and the Pacific: Selected Papers.* The first volume, published last year, presented a number of regional and sectoral studies on the service sector in the Asia-Pacific region. The present publication complements the first volume through a number of new studies on sectors and countries previously not covered, as well as through papers of a more general nature, which place the sector- and country-specific studies in the context of wider theoretical and negotiating issues, as they pertain to the service sector.

Most of these studies have been conducted under the UNCTAD/UNDP project for developing countries in the Asia-Pacific region to provide support for their participation in multilateral trade negotiations. At the beginning of 1990, the UNDP regional bureau for the Asia-Pacific region decided to make increased resources available to the project to permit the project to undertake major studies on trade in services in the region. These studies have sought to improve understanding on the role of the service sector in the region, to identify the problems faced by service firms in enhancing their competitiveness and their ability to penetrate international markets, and to assist in formulating appropriate policy measures, including through multilateral trade negotiations, towards this end. Many of the papers presented in this publication were products of discussions at a seminar for ASEAN countries and at a regional seminar for Asia-Pacific countries held in Bangkok in May and August 1990 respectively. These seminars were organized by the Asia-Pacific MTN project, funded by UNDP and executed by UNCTAD in association with ESCAP.

In addition to these, a number of papers and boxes, some of which were prepared by members of the UNCTAD secretariat, have been included so as to provide a more general framework to the studies. It is hoped that the present volume enriches and develops the concerns of its predecessor and that, together, they constitute a contribution to discussions on development strategies in the service sector in general,

and more particularly in relation to the specificities of the Asia-Pacific region.

INTRODUCTION

*Vijay Kelkar**

The recent focus on the service sector, especially in the light of the Uruguay Round negotiations on trade in services, has generated much interest in various aspects of the issue, including the development dimension of services and service trade. In several studies and reports, UNCTAD has explored a number of questions, such as the relations between development policies, strategies for the development of domestic service sectors, and the implications of increased international trade in services for developing countries. As these studies progressed, it became increasingly clear that in an area as heterogenous as services, it was extremely difficult to formulate generally valid development strategies that would be applicable to all sectors and countries. Questions of development would need to base themselves closely on country- and sector-specific analyses. Such insights would be necessary for developing countries to effectivelyparticipate in the sector-specific negotiations in the Uruguay Round negotiations on trade in services.

In Part II of the *Trade and Development Report 1988*, UNCTAD secretariat had examined in detail questions pertaining to services in the world economy, building upon its previous studies in this area since 1983. Over the past two years, UNCTAD has undertaken a large number of sectoral studies on a national, regional, and international basis. Some of these studies appeared in *Services and Development Dimension: The Indian Context* (United Nations Publication, UNCTAD/ITP/22), *Trade in Services: Sectoral Issues* (United Nations Publication, UNCTAD/ITP/26), and *Mexico: Una economia de servicios* (UNCTAD/ITP/58). As a sequel to these a number of new publications have been planned in order to examine issues that are specific to individual service sectors in certain countries or regions. The present publication constitutes the second volume of *Services in Asia*

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and the Pacific: Selected Papers. The first volume, published last year, comprised a series of studies on sectors as varied as insurance, media services, air transport, banking, computer software and tourism. The countries examined range from the newly industrializing countries of East Asia to continental economies such as India and countries relatively less covered by the literature on services, such as the Pacific Island countries. Publications dealing with the service sectors in the African and the Latin American regions are currently under preparation.

In the past years, countries from the Asia-Pacific region have registered a remarkable growth in the service sector. It has been estimated that by the close of the century more than half of the world production of goods and services will take place in the Asia-Pacific region, and that more than half of world trade will involve countries from the region. However, Asia and the Pacific, as a region, reveals a pronounced heterogeneity between countries in terms of development of service sectors, specific development strategies followed by individual countries and of the relative importance of the service sector to the national economies. The papers in the two volumes, in their turn, reflect this heterogeneity in the range of issues analysed.

However, in spite of the variety and range of the sectors and countries, a number of common themes emerge in the papers. These include the problems faced by service firms from Asia and the Pacific in penetrating world service markets, factors that determine the competitiveness of firms, questions that emerge in the context of the increasing use of advanced technologies in a large number of services, the dominance of transnational firms in a number of service markets, and the relations between trade liberalization in services and the cross-border mobility of factors of production such as capital and labour. Needless to say, these issues have been prominent in the Uruguay Round negotiations and their treatment in the proposed multilateral agreement on trade in services will have enormous implications for the service sectors and development process of countries from Asia and the Pacific.

While the first volume focused on sectoral studies, the present volume, in addition to presenting further studies at the sectoral and the national levels, also analyses the issues in relation to general service strategies in the context of social and economic development, as well

as to the Uruguay Round negotiations on trade in services. The first paper in the volume traces the developments in the services negotiations in the Uruguay Round, and provides a contextual background for the studies that follow. While Flavia Martinelli's paper analyses the problems central to an understanding of the relations between services and development policies, Michiko Hayashi's paper focuses on an issue of vital interest from the point of view of both social and economic development - the participation of women in the service sector in Asia-Pacific countries and the need for focused policies in this area. Dorothy Riddle's paper again addresses an issue of crucial importance for developing countries in the region, namely the potential for development and trade offered by the emergence of new, technology-intensive services.

The other papers in this volume present national and sectoral studies. There are two papers in the volume that provide brief national profiles of the service sector in two Asia-Pacific countries, i.e. China and Japan. The volume also contains a number of sectoral studies and cover areas which were not addressed in the first volume - medical services, construction and engineering, printing and publishing, entrepôt trade, and shipping. A series of boxes presents information some sectors of relevance to the studies. It is hoped that the papers included in this volume suitably complement those in the first volume, and that together they provide a picture of service sectors in the region in some detail. It is also hoped that the major issues for policy-making in the area have been indicated in these papers and that an attempt has been made to place them in the context of the Uruguay Round attempts to formulate a multilateral agreement on trade in services. A brief summary of the major arguments raised by the papers in the volume is given below.

In their paper, Murray Gibbs and Mina Mashayekhi outline the evolution of the services negotiations in the Uruguay Round and analyse the major negotiating issues that have emerged so far. The United States initiatives to include services in a new round of multilateral trade negotiations seem to have stemmed from three factors: pressures from service TNCs, strategies aimed at broadening the free-trade lobby to include service industries, and the recognition of the growing importance of services in the United States economy, exports and investment. After outlining the activities of UNCTAD in the field of services, the

authors discuss the negotiations on services within the Uruguay Round. The paper considers in detail the evolution of the negotiations subsequent to the Montreal Mid-Term Review. It examines in particular the Draft Framework proposals submitted before the Group of Negotiations on Services (GNS) and how these proposals have found their way into the documents currently before negotiators. The authors examine the current issues facing developing countries in the parallel negotiations under way on the draft multilateral framework, on the sectoral annexes and on "initial commitments" with respect to market access and national treatment at the sectoral and subsectoral levels. Gibbs and Mashayekhi examine the initial commitment offers submitted by various countries, and point out that all offers made so far are conditional on various factors, such as the quality and number of offers by other parties, the content of the framework, sectoral annexes, and the link between the framework and GATT, universal coverage, unconditional MFN treatment, etc. Finally, the paper addresses the outstanding issues in the negotiations. Gibbs and Mashayekhi emphasize the need to maintain a positive list approach for obtaining a balanced outcome to the negotiations. They also suggest other elements in the framework which would help in mitigating the asymmetry between developed and developing countries in world trade in services. These include the matching of any provision for free movement of capital with that of freer movement of labour, unconditional MFN, universal coverage, and recognition of the right of developing countries to stipulate conditions to foreign firms benefiting from concessions. They also point out that while the Uruguay Round negotiations are most likely to result in a framework for future negotiations on the liberalization of trade in services, it may not result in binding commitments to take positive action to strengthen the service sectors in developing countries and their ability to penetrate world markets. UNCTAD VIII will provide an appropriate forum for drawing up international commitments and mechanisms to this end.

Flavia Martinelli's paper addresses the services problematic - it provides an analysis of some major issues that underlie the present configuration of forces in the services sector. The author argues that the increased division and specialization of labour features a value-added chain in which services begin to prevail over material production phases. Advanced countries, due to their lead in services development,

create and retain within their borders the large majority of the world services' value-added. This appears to have led to a new international division of labour, where advanced countries dominate the highest value-added activities, and developing countries are left with the least value-added activities in the primary and the secondary sectors and assume "captive" production characteristics. Martinelli proposes four key parameters for assessing the role, the potential performance, and the policy guidelines regarding specific producer services in developing countries: the particular links to production, the factor content, the prevailing structure of supply and markets, and the degree of development and the size of individual countries. In her examination of the problematics of trade and development in services, Martinelli places these parameters in relation to a number of emerging contemporary issues such as the impact of new information technology (NIT), comparative advantages in services production and delivery, barriers to entry, and the international division of labour and value-added. She argues that the major impact of NIT is in the management of production and in service activities, and that it has enhanced the growing interdependence of contemporary economic activity and has increased the tradability of services. She points out that although less prone to be appropriated than other factors of production, the free circulation of information is constrained by factors such as the specific capital equipment needed, and the protection of access to information through proprietary devices. Martinelli argues that traditional notions of comparative advantage need to be revised in the light of economies of scale and instritutional factors which sustain the development of monopolies and oligopolies. "Man-made" conditions and resources influence trade patterns to a greater extent than "natural" endowments. Therefore, it is important to distinguish between basic determinants of comparative advantages in a competitive market and the effect of so-called distortions, i.e. of market power and government intervention. The paper points out that industrial concentration and the growing importance of large corporations are major determinants of barriers to entry and of trade distortions. In the light of these considerations, the paper concludes that the international division of labour at any time can be seen as influenced by previous rounds of accumulation and by unequal power relations in world markets, and that the concentration of both

production and consumption of producer services and NIT in developed countries needs to be viewed in this light.

Michiko Hayashi focuses on an issue that has not been adequately covered in most publications on services so far - the role of women in the service sectors - and reminds the readers that women have a high economic stake in the advancement of the services sector and in the results of the Uruguay Round negotiations on trade in services. The paper identifies four major areas in relation to women's contribution to the service sector - informal services, tourism, labour services, and public services. Focusing on the specific situation of Japan, Hayashi argues that the industrial and occupational structures of female employment do not indicate a significant difference from those in other countries in the region. However, as a result of the technological and social developments in the country, the job opportunities for skilled women have registered a sgnificant increase in recent years, especially in relation to computer-related skills. An increase in the number of women entrepreneurs in the service sector has also been observed. The author stresses the need for improvement in basic infrastructural services in order to facilitate women's increased contribution to the economy. The promotion of relevant skills among women, the strengthening of the organizational and managerial capabilities of informal enterprises, and the provision of legislative and other forms of support are all necessary elements in a strategy for strengthening the contribution of women to the development of the service sector. Hayashi cautions that, in spite of their high participation in the service sector, Asian women may not necessarily benefit from the liberalization of trade in services, unless adequate attetntion is paid by policy makers to the linkages between liberalization and the social construction of gender in service occupations, and to form well-balanced policies for the enhancement of the service sector, the development of human resources and the promotion of equal opportunties.

Paul Chan Tuck Hoong, in his paper, provides an examination of two major service sectors in the Malaysian economy - construction and engineering design on the one hand, and medical services on the other. Paul Chan notes that both these sectors are expanding rapidly - construction and engineering design due to the rapid implementation of large public projects and to an increase in demand for property and

houses, and medical services owing to the increasing demand for alternatives to government facilities. Analysing the market structure of the sectors, the paper notes that private limited companies accounted for the largest number of operating establishments, gross value output and employment in the construction sector in 1987. In the case of engineering design, a clear difference is visible between large firms usually responsible for large public projects, and smaller firms catering mainly to small and medium-scale enterprises in the manufacturing industry and in property development. Privatization of some specific large projects, as well as the supply of aid from developed countries have resulted in the relaxation of regulations regarding the employment of foreign consultants in the sector. Entry into the market for construction and engineering projects that require huge capital investment, high levels of technology, skills and expertise, is usually very difficult, and this segment of the market shows domination by a very small number of giant construction and engineeering design firms. In the field of advanced engineering projects such as the construction of bridges, foreign firms have an advantage in relation to local firms, by virtue of their technological superiority. Competition is at times stifled due to the granting of engineering projects to firms from countries that have provided the aid to finance the projects. Malaysian exports in the sector have been mainly to other countries in the Asia-Pacific region, and this can be attributed to geographical proximity, market information, compatibility of engineering systems, and familiarity with the culture and values of countries in the region. Health indices in Malaysia have shown a significant improvement since independence, indicating a better state of health care than most developing countries in the region. The market for medical services is characterized by a rigid separation between the public and the private sector, which partly comes from the structure of the sector before independence. The author argues that a reorganization of health care is needed in order to ensure better coordination between the public and the private sectors, through a sharing of role, functions and cost. There is a concentration of private hospital beds in urban areas, resulting in duplication of facilities. In the case of in-patient medical services, the public-sector hospitals cater to most of the low and the middle-income customers, while private hospitals cater mainly to upper-income customers. Public-sector hospitals ensure the provision of health services at affordable price to the population, the

pricing policy being based on a categorization of customers into three income groups. The export of medical services from Malaysia is currently constrained by insufficient capacity, an inadequate level of technical competence in relation to competitors, and by regulations concerning the supply of medical services in target countries. Paul Chan argues that an integrated strategy for the development of Malaysia's service exports should include measures to upgrade the relevant infrastructures, secure international recognition of domestic standards and qualifications, closer co-ordination between the public and the private sectors, the improvement of the country's human capital, and multilateral efforts to secure a balanced regime for international trade in services.

Rajwar's paper on shipping provides a picture of the shipping sector in three Asia-Pacific countries, namely India, Malaysia and Thailand. Rajwar argues that although developing countries have a comparative advantage in shipping services on account of cheaper crewing and establishment costs, this advantage has been neutralized by the prevalence of open and parallel registries which, by preventing the relocation of shipping to lower-cost developing countries, have cre ated the largest single distortion in the international shipping market. Furthermore, through the large-scale employment of shipboard officers, open and parallel registries have also caused a reverse resource transfer from developing countries. India, which possesses fourth largest fleet among developing countries, had a share of 1.54 per cent of the total world fleet in 1989. As the Indian fleet was developed primarily to cater to the country's own trade, its composition differs considerably from that of the world fleet. Government policies have had a significant bearing on the development of Indian shipping industry and its role in the national economy. The Shipping Development Fund was the major means of Governmental financial support in the sector for three decades until 1987, when it was replaced by a new organization which raises its own funds, provides loans to private shipping companies, and operates on a commercially viable basis. The Government follows a policy of cargo support, taking into account balance-of-payments considerations as well as the development of the national shipping industry. The Shipping Corporation of India, a public sector company, is the largest in the Indian shipping industry, and is dominant in crude oil tankers and general cargo tonnage. Thailand, which ranks fifty-eighth

among world merchant fleets, uses almost 60 per cent of its dry cargo fleet in intra-ASEAN trade. Cabotage and cargo aupport form part of the Thai shipping poilicy as well. Shipping companies are also granted exemptions from taxes, imports or exports. Joint ventures are encouraged between Thai entrepreneurs and foreign firms in order to modernize the country's fleet. The merger of smaller companies to form larger companies is encouraged. Containerization of a significant proportion of the fleet and the replacement of old vessels are among the short-term objectives of Governmental action. Malaysia's fleet, the fortieth in the world in terms of size, contains several specialized ships such as chemical tankers, gas carriers, etc., reflecting the pattern of the country's foreign trade. The largest shipping company in Malaysia, originally established as a Government undertaking, has been privatized to a considerable extent in recent years. Malaysian shipping policy also involves cargo support, cabotage, tax exemptions, etc. Rajwar points out that containerization has affected direct liner services to smaller ports in Malaysia, and that this has had an adverse effect on industries on certain parts of the country.

Zhangzhou Li addresses the development of the services sector in China and examines the major problems faced by the service strategies in the country in strengthening the domestic service sectors. He argues that a neglect of the service sector and a bias in towards heavy industry in China resulted in a disequilibrium in the economy between the industrial and the services sectors. This neglect can partly be attributed to a misunderstanding of the role of services in the economy - to the notion that services are essentially unproductive and that their function is to redistribute the wealth created by material production units. However, over the past decade, the service sector has received increased attention and its contribution to the gross national product increased from 20 per cent in 1979 to 25.7 per cent in 1988. Nonetheless, the author points out that services have continued to be in short supply in the country, as the manufacturing sector has outgrown the service sector. Shortages in production-supportive services such as transport, post and telecommunications constitute a major bottleneck, constraining the growth of aggregate social supply. Li identifies a number of factors behind the underdevelopment of the service sector. They include inadequate investment and inadequate compensation for

the value of services provided, as well as the non-specialization and non-commercialization of services. The paper considers in some detail some specific service sectors. In financial services, Li outlines measures undertaken since 1979 for the reform of the banking system and of the exchange-control system, for extending the scope of baking operations and of new financial instruments, and for a partial, progressive liberalization in the sector. Li stresses the need for enhancing the insurance sector by developing the domestic market, and argues that due to financial weakness and to the lack of necessary expertise, the Chinese insurance sector may not gain much from liberlizing the domestic market. The export prospects of the Chinese construction sector, Li suggests, will depend mainly on the market-access situation. The paper concludes by considering important policy issues, such as the need for a pricing system with welfare considerations, a programme of structural reform to allow service firms to accumulate investment funds, and measures to deal with the shortage of infrastructural services.

The paper prepared by the Japan Research Institute provides an outline of the Japanese service sector and the regulatory structure therein, particularly in the context of the Uruguay Round negotiations on trade in services. The paper addresses seven service sectors: banking, securities business, insurance, telecommunications, -transport, construction and labour mobility. In many of these sectors, even though efforts have been made towards liberalization, there are regulatory as well as non-regulatory restrictions that foreign firms perceive as discriminatory. The paper points out that some of the difficulties faced by foreign firms may be attributed to their lack of adequate access to Japanese trade practices and regulations, and that greater transparency could aid in allaying them. For example, in the banking sector, the administrative guidelines provided by the Government may not be transparent to foreign firms, and criteria for issuing certain licences are not written and published. There have also been criticisms about the allocation of cargo-handling facilities in the major airports which have reached their maximum capacity. Another major issue in the Japanese service sector concerns the question of labour mobility. There have been proposals for a "project-oriented" approach (i.e. hiring unskilled workers for specific projects from overseas), and for the establishment of a public agency to receive foreign workers and arrange for their training, work, and eventual return. However, Japan is yet to decide

on whether and on what terms it should open its labour market to foreign workers. Japanese foreign direct investment in services has increased rapidly over the past years, while the level of inward investment in Japan still remains at a rather low level. Last year, the openness in investment policy was affirmed by the Government, and since then programmes for the promotion of inward investment have been elaborated. In relation to the Uruguay Round negotiations, the paper argues that while national regulations would need to retain some of their features owing to historical and socio-economic reasons specific to individual countries, an effort would need to be made for the revision or elimination of some regulations which unreasonably restrict trade in services. This could be based on an examination of regulations on a sectoral basis, taking into account the following: consumer protection, national security, national identity and cultural traditions, independence of the national economy, and the balance between increased competition and measures that restrict competition.

Dorothy Riddle's paper argues strongly for focused services policies in developing countries, which take adequate account of the trade and development potential offered by the new, technology-based services. Such potential stems primarily from two sources of competitiveness in services - i.e. human capital development and information management - and merits special attention in relation to countries in the Asia-Pacific region which have registered remarkable progress in the production and trade of services. In relation to human-capital development, Riddle draws special attention to investments in general education, management training, entrepreneurial development, and to export opportunities in labour-force development. The development of telecommunications infrastructures in order to facilitate the delivery of many of the new services forms another crucial element in developing-country policy-making in the service sector. Riddle argues that for identifying new export opportunities in services, one must move beyond traditional concepts of new geographic markets or new service products for existing markets to a model of the types of services that can generate trade opportunities, taking into account the various modalities of service delivery involved. The author considers a variety of such opportunities in a large number of sectors, ranging from traditional services such as construction to new services that make use

of telematic technologies. In the light of the dominant trends in the international market for services, the paper considers the potential implications of liberalization for developing countries. In relation to the prospect of liberalization, there is often a conflict of interests between various constituencies of developing economies, as for example between local firms which will benefit from foreign sourced service inputs on the one hand, and those which compete at a disadvantage with foreign service firms. The structure of the particular service sector is crucial in determining the impact of liberalization on developing economies, and there may not be any single trade regime which will benefit all sectors. Therefore, Riddle argues, developing-country strategies in services may need to make use of a range of policy instruments. The author lists a number of such instruments related to domestic policy (e.g. development of infrastruture, changes in tax structure), trade infrastructure (encouraging entrepreneurship, developing networked environments, strategic procurement, export assistance), and multilateral policy initiatives (e.g. unrestricted cross-border mobility of labour, performance measures for transnational corporations, targeted incentives). Riddle concludes that the key to increased service exports lies in government support for the type of innovation and entrepreneurial activity necessary for developing high value-added service exports.

Discussing the state of printing and publishing services in Sri Lanka, W.A.J. Anton Fernando notes that the removal of several import restrictions by the Government in 1977 aided the growth of the sector in technological capability and productivity. This has also facilitated modernization of equipment in printing, block-making, binding, etc. Fernando argues that the high duty and turn-over tax on the import of paper has adversely affected the industry. Lack of modernization in machinery and low efficiency have prevented the domestic paper industry from becoming competitive. These constraints seem to annul the comparative advantage Sri Lanka has in printing and publishing by virtue of low labour costs. The author argues that publishers find it cheaper to get their books printed abroad and imported to Sri Lanka than to print them within the country. The lack of development of an adequate distribution system, the prohibitively high costs of foreign training, limitations of the local market, the high costs of sea and air freight, and an inadeqaute awareness of international standards of quality control are further constraints on the development of these sec-

tors. However, with appropriate government policies, Sri Lanka might be in a better position to take advantage of the availability of skilled and talented labour, the geographical position of the country, and the capacity of the local printing industry. Such policies could include the reduction of tariffs on imported raw materials, encouragement of exports through subsidized air fares, low-interest loans and tax incentives for the modernization of technology, and the organization of sales fairs and training programmes.

In his paper on entrepôt trade, Anton Fernando examines the potential for growth and increased trade in this sector. The author argues that the development of this secor may increase Sri Lanka's foreign-exchange earnings, generate both direct and indirect employment, strengthen the service capacity of ports and airports, and enhance the potential for exports from the country. Fernando analyses a number of factors that act as barriers to the development of entrepôt trading services. These include government measures such as the inadequacy of financial incentives, cumbersome regulations on exchange control, customs, and port administration, as well as the inadequate development of warehousing facilities. A removal of these barriers could greatly facilitate the expansion of entrepôt trade. For example, requirements on the establishment of back-to-back letters of credit for each consignment of goods and the insistence on landing certificates could be dispensed with in the case of entrepôt trade. The author argues that a greater harmonization of the activities of the customs authorities and the port authorities can help the removal of many of the administrative complications. Furthermore, offshore trade could be developed through the relaxation of the requirement that goods have to physically arrive in Sri Lanka in order to qualify as entrepôt trade. Fernando also suggests that the warehousing facilities in ports and airports need to be modernized and channelized. The enhanced competitiveness of services such as transport, sea and air freight, and financial services is also a pre-requisite for the expansion of entrepôt trade.

Maria Dunavolgyi's paper discusses the state of service-trade statistics in six countries and territories in the Asia-Pacific region - Republic of Korea, Hong Kong, Thailand, Singapore, Sri Lanka, and India. This area is of particular importance to any discussion of the service sector, as differences between the statistical practices of individ-

ual countries often make a clear understanding of the state of service transactions and a formulation of focused policies very difficult. Against the background of the recent attempts at an international harmonization of service-trade statistics, the paper examines the information sources, data collection systems, scope and coverage, and the breakdown applied in the statistics of these countries. While the main items used usually follow the recommendations of the International Monetary Fund (IMF), there are differences between countries in relation to the level of disaggregation. The author points out that service statistics are often determined by the regulatory structure of the country. While countries which have strict regulations on foreign-exchange transactions use exchange records as a major source for statistical information, countries with more liberal regimes use surveys for collecting data. Both methods appear to have certain limitations in relation to coverage. Further differences exist between countries as to the determination of residency, especially the treatment of categories such as students and refugees. The author also analyses the statistical practices of these countries according to the standard components - shipment, other transportation, travel, government services, other private services, and incomes and unrequited transfers. While individual-country practices show divergences in many of these areas, attempts are being made by countries to reform their practices in order to provide greater detail and greater harmonization at an international level.

The overview paper in Volume One had identified a number of common problems faced by developing-country firms from the Asia-Pacific region in penetrating international service markets. They were (a) access to technology and training facilities, (b) market entry and the dominance of TNCs, (c) access to information networks and distribution channels, (d) financial strength, (e) movement of persons, and (f) government policies. While the national and sectoral studies in the present volume share these concerns and throw further light on these problems, the general, conceptual papers place these issues in larger contexts, i.e. that of a theoretical framework for analysis and policy-making in the services sector, and that of the Uruguay Round negotiations on trade in services. It is hoped that the papers in this volume thus enrich the picture provided in the first volume through the provision of further detail and a more general analytical framework. It is also hoped that both these volumes together provide valuable guidelines

for developing country policy-making in the service sector, especially in the Asia-Pacific region.

DEVELOPMENTS IN THE URUGUAY ROUND NEGOTIATIONS ON TRADE IN SERVICES

*Murray Gibbs and Mina Mashayekhi**

INTRODUCTION

After the suspension of the Uruguay Round negotiations at the Brussels Ministerial meeting of December 1990, the negotiations on trade in services have recently resumed in earnest, with an ambitious work programme for June and July 1991. This chapter is intended to provide background with respect to the evolution of the negotiations to date (i.e. as of 22 June 1991).

I. THE INITIATION OF NEGOTIATIONS ON TRADE IN SERVICES

A. The background to the debate on services

The first use of the term "trade in services" in international debate seems to be that in the OECD "Rey Commission" Report which commented on the issues for the then upcoming "Tokyo Round". In the Tokyo Round, the United States Administration had a sufficient mandate to negotiate on services under Section 102 (g) of the Trade Act of 1974, although neither the United States nor other participants sought specific concessions in the services sector. However, certain provisions dealing with trade-related services were incorporated in the Tokyo Round results, in the Code on Customs Valuation, and in the Code on Government Procurement.[1] During the Tokyo Round, the United

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1 See R. Krommenacker, "Trade Related Services in GATT", *JWTL*, Vol. No. 6,

States Government continued to conduct research on services and, upon assuming office, the Reagan Administration immediately gave priority to the services issue. A Services Advisory Committee was established to provide direct government industry collaboration on issues relating to trade in services. The United States accordingly initiated in 1980 a public- relations campaign aimed at achieving an "international consensus"[2] for negotiations on services under GATT auspices, including academic research, high level seminars and a work programme on services in the OECD.[3] The United States advocacy of liberalization of services trade appears to have been a result of three factors: (a) response by the Administration to the pressures from various transnational corporations (TNCs); (b) a political decision to attempt to broaden the "free trade lobby" to include service industries, and thus to offset the growing political power of protectionist interests; and (c) the recogni-

November/December 1979. See also Murray Gibbs, "Continuing the International Debate on Services", *JWTL*, Vol. 19 (May/June 1985).

2 Geza Feketekuty, in *International Trade in Services: An Overview and Blueprint for Negotiations* (Cambridge, Ballinger, 1988), explains how the United States Government headed a lobby to press for trade negotiations on services.

3 The OECD has as an objective the liberalization of trade in goods and services for the past 30 years. In the Convention on the OECD signed on 14 December 1960, the member states agreed individually and jointly to "pursue their efforts to reduce or abolish obstacles to the exchange of goods and services and current payments and maintain and extend the liberalization of capital movement and services" and have continually reaffirmed it in subsequent years. OECD has adopted the Code of Liberalization of Invisible Operations, 1961, the Code of Liberalization of Capital Movements and the Declaration on National Treatment, 1976 and has carried out considerable work on the right of establishment. These Codes, however, apply only to OECD countries and are restricted by various reservations and derogations lodged by signatory nations. Moreover, the Codes have no enforcement mechanism. The Annual OECD Ministerial Meeting reaffirmed, in April 1986, its support for extending and making more effective the relevant OECD instruments in order to promote liberalization and the inclusion of services in a new round of Multilateral Trade Negotiations. For example in banking and financial, the extension of the Codes is the largest of any sector dealt with so far. Under Decisions adopted by the Council in May 1989, the liberalization mechanism of the Codes will apply to: all capital movements, including money-market operations, forward operations, swaps, options and other "innovative" activities not previously covered by the Capital Movements Code; cross-border services to be specified in a new section of the Current Invisible Code devoted to "banking and financial services" and including payment services (e.g. the issuance and use of cheques, travellers' cheques and credit cards), banking and investment services (e.g. underwriting and broker/dealer services), asset management (e.g. portfolio management and pension fund management), and advisory and agency services (e.g. investment research and advice). In addition to the main aspects of the right of establishment already covered by the inward direct investment item (I/A) of the Capital Movements Code, the Current Invisible Code will contain specific new provisions concerning establishment under which branches and agencies of non-resident financial institutions must be treated no less favourably than domestic institutions.

tion that services were of growing importance in the United States economy and as a component of United States' exports and investment abroad.

The United States Administration in Title III of the Trade and Tariffs Act of 1984 provided the mandate for negotiations on trade in services, as well as on investment (which was defined as "trade") and intellectual property. The pursuit of the objectives defined in the Act was supported by a credible threat of sanctions against offending countries, including the right to withdraw concessions on goods of countries which neither subscribe to nor apply these principles on services.[4]

The United States argued that the priority issue of the 1982 GATT Ministerial Session was to establish a work programme on services to prepare the technical base for multilateral negotiation in this

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4 The enactment of the Trade and Tariffs Act (TTA) on 30 October 1984 (Public Law No. 98-573) provided the United States' Administration with a coherent integrated approach to negotiate on goods, services, high technology and investment, and identified the issues which that country would raise in such negotiations. Title III of this Act, itself cited as the "International Trade and Investment Act", amends the Trade Act of 1974 in several important respects, integrating trade, services, investment and technology objectives, and including a new concept of reciprocity, that of the "achievement of commercial opportunities in foreign markets substantially equivalent to those accorded by the United States".

The United States' negotiating objectives on services and investment include: (a) the reduction and elimination of barriers which deny national treatment and restrictions on establishment and operation in such markets; and (b) the development of international rules, including dispute settlement procedures, in conformity with this objective. Cited as examples of such barriers and distortions are "direct or indirect restrictions on the transfer of information into or out of the country" and "restrictions on the use of data processing facilities within or outside such country" (Section 305).

This same Title III contains negotiating objectives on "high technology products" which draw the link between services, investment and technology. For example, one of the principal negotiating objectives is to "obtain and preserve the maximum openness with respect to international trade and investment in high technology products and related services". The main target is "foreign government intervention affecting United States exports of high technology products or investments in high technology industries" including "foreign industrial policies which distort international trade and investment" and "measures which deny national treatment or otherwise discriminate in favour of domestic high technology industries". Among the specific objectives are "national treatment" to "obtain commitments that official policy of foreign countries ... will not discourage government or private procurement of foreign high technology products and related services" and reduction, elimination of other barriers. Subsequently, the Omnibus Trade and Competitiveness Act 1988 renewed the President's multilateral and bilateral negotiating authority, establishing negotiating objectives for the Uruguay Round and inter alia strengthening the United States Trade Representative's retaliatory powers.

area.[5] However, the developing countries and some developed countries resisted the United States' initiative. The arguments of the developing countries against negotiating on services issues within GATT were not in themselves arguments against liberalization of trade in services. In their opinion, however, agreeing to discuss services under GATT auspices could create an assumption that GATT provisions should be extended to services and these concessions on goods and services would be contained in a single instrument; and could serve to legitimize the use of retaliatory provisions of the United States Trade and Tariff Act of 1984. Although the EC initially appeared to share many of the misgivings of the developing countries, it was nevertheless instrumental in finding a compromise position which was ultimately adopted at the 1982 meeting, namely that contracting parties with an interest in services undertake national studies on trade problems in this sector and exchange relevant information through international organizations "such as GATT". The results of these examinations, along with the information and comments provided by the relevant international organizations, were to be reviewed at the 1984 (40th) GATT Session. The decision also empowered the Contracting Parties to consider whether action on negotiations on services was appropriate and desirable.

Submissions were prepared by most industrialized countries[6] prior to the November 1984 GATT Ministerial Meeting. This meeting gave a formal character to the procedure which had been established for the examination of the national studies during 1984, and set out a narrowly circumscribed role for the GATT Secretariat to support this process, including that of proposing a "common format" for the national studies. It was decided to establish a working group aimed at improving information regarding services. Discussions on this issue were also held at the Preparatory Committee for the Ministerial Meeting which was to be held in September 1986 at Punta del Este.

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5 It should be noted that the United States, at the 1982 Ministerial Meeting, already had sufficient mandate to negotiate on services agreements under Section 102 (g) of the Trade Act of 1974 which defined "international trade" as trade in goods and services. The mandate indicated that the Government should negotiate to liberalize regulations in trade in goods as well as in services.

6 Studies were submitted by the EC and its member States, as well as by Canada, the United States, Australia, Japan, Norway, Sweden and Finland.

During the following two years, the EC played an important role in reconciling the United States' pressure to include services in the new round with developing countries' insistence that the services issue lay outside the competence of the GATT. During the Special Session of the Contracting Parties held in September 1985, negotiations on the inclusion of services in a round of multilateral trade negotiations in GATT continued. Subsequently, the Senior Officials Group, the 41st Session of the Contracting Parties in November 1985, and the Preparatory Committee, during the first half of 1986, also discussed the services issue. At the June-July 1985 GATT Council Meeting, the United States defined its position on services[7] by elaborating its negotiating objectives, under the headings of:

- Transparency;
- National treatment;
- Open regulatory procedures;
- Public monopolies;
- Dispute settlement;
- Market access;
- Investment (advocating a "right of commercial presence");
- Sectoral negotiations; and
- Negotiations of a functional character (application of GATT Codes dealing with non-tariff barriers to trade and a link to obligations on intellectual property).

II. THE NEGOTIATIONS ON TRADE IN SERVICES

A. The Punta del Este Declaration

A number of developing countries continued to oppose inclusion of services in the future Round. However, a compromise was finally reached at the September 1986 Punta del Este Ministerial Meeting that launched the Uruguay Round. The "Ministers" (i.e. not the "Contracting Parties" of the GATT) agreed to launch negotiations on trade in services as part of the new round of MTNs and embodied their decision in Part II of the Uruguay Declaration as follows:

7 GATT document L/5838.

> Negotiations in this area shall aim to establish a multilateral framework of principles and rules for trade in services, including elaboration of possible disciplines for individual sectors, with a view to expansion of such trade under conditions of transparency and progressive liberalization and as a means of promoting economic growth of all trading partners and the development of developing countries. Such framework shall respect the policy objectives of national laws and regulations applying to services and shall take into account the work of relevant international organizations.
>
> GATT procedures and practices shall apply to these negotiations. A Group on Negotiations on Services is established to deal with these matters. Participation in the negotiations under this Part of the Declaration will be open to the same countries as under Part I. GATT Secretariat support will be provided, with technical support from other organizations as decided by the Group on Negotiations on Services. The Group of Negotiations on Services shall report to the Trade Negotiations Committee...
>
> When the results of the Multilateral Trade Negotiations in all areas have been established, Ministers meeting also on the occasion of a Special Session of the CONTRACTING PARTIES shall decide regarding the international implementation of the respective results.[8]

The above text carefully balanced the United States' objective of including services in the Uruguay Round, and the developing countries' dual objectives of maintaining multilateral action on services (as distinct from goods) outside the GATT, and of obtaining recognition of the priority of development objectives and the supremacy of national laws and regulations.

The developing countries thus ultimately agreed to participate in the MTNs on services to preempt unilateral actions against them and the proliferation of discriminatory bilateral and regional arrangements.[9] They were, however, successful at Punta del Este in establishing a legally distinct negotiating process on trade in services to be conducted in an *ad hoc* juridical frame of reference outside GATT. Formal trade-offs and linkages between goods and services has thus been excluded from the outset of the negotiations. They were also successful in establishing a balanced objective for the negotiations on trade in services, i.e. the promotion of economic growth of all trading partners

8 Ministerial Declaration on the Uruguay Round (MIN(86)/6).

9 For a summary of the Indian and Brazilian statements at the Group of Negotiations on Services on 25 February 1987, see C. Raghavan, "Trade: Services Negotiations Start", *Special United Nations Service*, No. 1664, 3 March 1987.

and the development of developing countries through expansion of trade in services under conditions of transparency and progressive liberalization. Hence, the objective of development, as provided in the Ministerial Declaration, is an integral part of any set of rules to be devised in trade in services. During the four years of negotiations on trade in services, the developing countries have had to negotiate forcefully to preserve the balance achieved in Part II of the Ministerial Declaration, between these various objectives.

B. The Group of Negotiations on Services

On 28 January 1987, the Negotiating Group on Services decided upon its work plan for the initial stages of the negotiations[10] during which the following five "elements" would be addressed:

- Definitional and statistical issues;
- Broad concepts on which principles and rules for trade in services, including possible disciplines for individual sectors, might be based;
- Coverage of the multilateral framework for trade in services;
- Existing international disciplines and arrangements; and
- Measures and practices contributing to or limiting the expansion of trade in services, including specifically any barriers perceived by individual participants, to which the conditions of transparency and progressive liberalization might be applicable.

The discussion that took place indicated that there were different views regarding the relative weight to be given to the five elements. Moreover, views also varied as to the extent to which it was necessary to deal with one element before another could be addressed. Whereas, developing countries endeavoured to concentrate the discussions on the issues of definition, statistics, coverage and development, developed countries were more concerned with broad concepts and barriers to trade in services. The discussion, however, reflected an awareness of the linkages that exist between the issues that emerge when dealing with the various elements. At the stock-taking held at the end of 1987, it was recognized that the negotiating programme would be carried forward on the basis

10 "The Programme for the Initial Phase of Negotiations", MTN.GNS/5.

of the examination of the five elements in the initial phase of the negotiations as well as of other issues arising therefrom. These elements provided the framework for the negotiations until the Montreal Mid-Term Review. The discussions identified the following needs: to improve the availability of statistics in relation to trade in services; to study the sectoral applicability of the concepts such as national treatment, transparency, non-discrimination, market access, reciprocity/relative reciprocity, development compatibility etc.; to examine criteria and procedures that would permit measures and practicesto be taken up for progressive liberalization while safeguarding the national policy objectives which may underlie individual national regulations; to provide for the broadest possible sectoral coverage to ensure a balance of interests among participants; to identify the extent to which, and the conditions under which, service transactions based on movement of factors of production are covered; to reach decisions on the negotiating modalities, the nature of concessions and operational structure of the framework. The process of discussion and consultation culminated in the drafting of the Report to the Trade Negotiations Committee meeting at ministerial level at Montreal in December 1988 which endeavoured to capture the[11] progress made in the negotiations and to seek guidance on future work of the Group. The Report contained a significant number of bracketed/alternative wording which enabled the participants to identify the concerns which underlied national positions.

C. The Montreal "Mid-Term Review"

At the December 1988 Montreal Mid-Term Review Meeting of the Trade Negotiations Committee, Ministers reviewed the progress achieved on trade in services and sought to give direction to the negotiations. A set of guidelines was adopted in Montreal to set aside many of the obstacles encountered at the GNS. Work was to proceed on a definition of trade in services, flexible enough to include those services, the delivery of which required the movement of factors of production across borders - i.e. trade in services involving cross-border movement of services, cross-border movement of consumers, and cross-border movement of factors of production where such movement is essential

11 MTN.GNS/21.

to suppliers. It was decided that this issue should be examined further in the light of, *inter alia*, the following:

- Cross-border movement of service and payment;
- Specificity of purpose;
- Discreteness of transactions; and
- Limited duration.[12]

No mention was made of the issue of 'labour' or "labour-intensive' services, nor specifically of capital movement. The compromise formulation provided for negotiations on these issues by agreeing that work on definition should be on the basis that the proposed multilateral framework may include trade in services involving 'cross-border movement' of services, of consumers, and of 'factors of production' (which includes both capital and labour) where such movement was essential to suppliers. Moreover, it was decided that work would proceed without excluding any sector of trade in services *a priori*.

The Mid-Term Review enumerated specific concepts, principles and rules which were "considered relevant" for a framework agreement on trade in services; this indicated the future orientation of the work of the negotiating group. The following concepts, principles and rules were considered relevant: transparency, progressive liberalization, national treatment, MFN/non-discrimination, market access, increasing participation of developing countries, safeguards and exceptions, and regulatory situation. The developing countries were able to obtain recognition of the need to strengthen their domestic services capacity and to introduce new regulations in the process of reducing the asymmetries between developing and developed countries in order to facilitate market access for the services of developing countries through improved access to distribution channels and information networks, and to provide flexibility for individual developing countries in the rules, modalities and procedures for progressive liberalization. Ministers also agreed that before the concepts, principles and rules which comprise a multilateral framework for trade in services were finally agreed, these concepts, principles and rules would have to be examined with regard

12 MTN.TNC/1 (MIN).

to their applicability and to the implications of their application to individual sectors and types of transactions to be covered by the multilateral framework.

Although the concept of 'development compatibility'[13] was not specifically included, some of the content of the concept was included in other concepts. As provided in paragraph 8 of part II of the TNC document on its meeting at Montreal,[14] MTN.GNS/21[15] also includes other concepts, on which agreement was not reached at Montreal but which would be considered further such as:

> consultation and dispute settlement mechanisms, regional economic integration, regulatory situation, obligations to respect the value of concessions, provisions for competition, relative reciprocity, preferential market access opportunity/priority liberalization of market access, access to modern technology, enhancing of national services capacity, activities and practices of market operators, sovereignty of national economic space, autonomy of macroeconomic policies, preferential arrangements among developing countries, financial support, standstill.

Some of these concepts, including those of considerable importance to the developing countries, such as relative reciprocity, access to modern technology, activities and practices of market operators, enhancing national services capacity and sovereignty of national economic space have been retained in the draft multilateral framework.

It was decided to include in the work programme the compilation by the Secretariat of a reference list of sectors (nomenclature) and the submission by the participants of indicative lists, which would facilitate the examination by the GNS of whether certain concepts could be applied to individual service sectors and with what effect. Ministers also agreed that the GNS should endeavour to assemble the necessary ele-

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13 The concept provided that the agreement shall be compatible with the objectives of promoting the economic growth of all trading partners and the development of developing countries, including the improvement of signatories' technological capacities and their capacity to attract and generate higher levels of investment. It is understood that negotiations shall proceed on the basis that individual developing countries might open fewer sectors or liberalize fewer types of transactions than other signatories, in line with their level of development, or that market access might be phased in over a longer period.

14 MTN.TNC/7 (MIN).

15 This document contains the report of the GNS to the TNC meeting at Ministerial level in Montreal.

ments for a draft agreement by the end of 1989, and to achieve its completion and entry into force by the end of the Uruguay Round. On statistics, further work on available statistical data (classification, trade flows and features of trade in services), in particular their disaggregation, was deemed essential. The GATT Secretariat drew up a reference list of some 25 service sectors[16] to provide a classification for the sectoral discussions. This reference list is based on a product classification and constitutes an aggregated version of the planned Central Product Classification (CPC).[17] This methodology and the disaggregation of services sectors has subsequently been found inadequate by many countries (e.g. in the areas of tourism, financial services, telecommunications) in particular in the context of the negotiations of initial commitments.[18]

Agreement was also reached that work should proceed without excluding any sector of trade in services on an *a priori* basis, with a view to reaching agreement on the sectoral coverage under the multilateral framework in accordance, *inter alia*, with the consideration that coverage should permit a balance of interests of all participants, that sectors of export interest to developing countries should be included, that certain sectors could be excluded in whole or in part for certain overriding considerations, and that the framework should provide for the broadest possible coverage of sectors of interest to participants. Understanding was also reached informally at Montreal that the acceptability of the multilateral framework will depend on the initial level of negotiated commitments of signatories.

16 MTN/GNS/W/50.

17 A variety of sectoral classification systems could be used as a basis for delineating a reference list of sectors. Statistical classification systems answer to three broad characterizations, depending on whether their respective focus is on activities, products or international transactions. The International Standard Industrial Classification (ISIC) and the System of National Accounts (SNA) are examples of the first type; the planned Central Product Classification (CPC) typifies the second type; and the IMF Balance of Payments (BOP) is an example of the third category.

18 It should also be noted that the classification and terminology used is different from those used in the national classification systems and by businesses.

D. Implementation of the Montreal Decision

At its April 1989 meeting, the Group decided that the sectoral examination would begin with the telecommunications and construction sectors, to be followed by transportation, tourism, financial and professional services. Subsequently, the GNS initiated the process of "sectoral testing" forseen in Part II, paragraph 6 of the Montreal Decision. In each case, general comments were made on each sector followed by the consideration of the principles and concepts listed in paragraph 7 of the Montreal text. The Group also carried out a horizontal consideration of the concepts contained in the Montreal text. The principles of transparency, progressive liberalization, national treatment, MFN and non-discrimination, market access, increasing participation of developing countries, safeguards and exceptions, and regulatory situation were examined.

It should be noted that the six sectors were examined without prior discussion on the definition of trade in services (paragraph 4 of the Montreal Decision), the composition of sectors, and the types of transactions to be covered (paragraph 6). The developing countries participated actively in the examination of the sectors. For example Mexico submitted papers on the applicability of the concepts to tourism, construction and financial services sectors.

The pace of the negotiations did not permit much more than a superficial examination of the sectors. Developed countries reiterated explicitly or implicitly many of their initial opinions and arguments; for example, that national treatment and market access were obligations and not objectives.

At the end of the sectoral testing exercise in September 1989 the programme for the continuation of work was adopted as follows:

> With regard to the work programme in paragraph 10 of the Montreal Declaration and with a view to the fulfilment by the end of this year of the mandate contained in paragraph 11 of the Montreal Declaration, the GNS shall: (i) discuss any submissions put forward by participants during the course of this year concerning the structure and content of the future framework on services as well as particular concepts, principles and rules; (ii) discuss specific issues mentioned in the Montreal Declaration or arising from the discussions in the

GNS during the course of this year which in the view of participants needed further examination or clarification; (iii) expedite its work towards the assembly of the necessary elements for a draft which would permit negotiations to take place for the completion of all parts of the multilateral framework.[19]

In December 1989, the Group concentrated on the assembly of the necessary elements for a draft which would permit negotiations to take place for the completion of all parts of the multilateral framework to fulfil the provision of paragraph 11 of the Montreal text. The Group drew up some "draft elements" which were mostly in square brackets.[20] The provisions on increasing participation of developing countries, which had been agreed on in Montreal, were bracketed in the 'Elements' document. While most developed and some developing countries considered that the draft elements contained too many bracketed provisions, or in some instances did not go far enough, there was also the opinion that the document did not include some important notions from the Montreal Declaration (while it included some commitments going beyond the previously agreed texts). The developing countries were of the opinion that issues of development should not be considered as part of trade-offs, but should represent an integral part of the eventual framework's structure.

Most of the developed countries nevertheless felt that the possibilities for a successful agreement rested on the ability of all signatories to accept qualitatively equal binding commitments by the end of the Uruguay Round. They specifically denounced a situation of "free-rides" or "blank checks". With regard to the draft of 18 December 1989, some developed countries felt that "a degree of concrete movement" was reflected only in its portions on transparency, MFN/non-discrimination, national treatment, regional regulations, and sectoral annotations. The text was nevertheless a "full inventory of tasks the Group had to achieve during 1990". It is of interest to note that the EC observed that three stages had to be accomplished in 1990: (a) a general consensus on the objectives of the framework, (b) negotiation of the framework itself, and (c) negotiation of access commitments and that the document before

19 MTN.GNS/25, p.110 paragraph 259.

20 MTN.GNS/28.

the Group indicated that not even the first stage of consensus building had yet been achieved in December 1989.

In its meeting of 16 to 19 January 1990, the GNS adopted an ambitious timetable and indicative agenda of meetings until July 1990. The following issues were included in the indicative agenda: structure of the framework, statistics, role of other international arrangements and disciplines, mechanics of liberalization, undertakings including the nature of initial commitments, definition and increasing participation of developing countries, institutional issues, identification of sectors requiring annotations and the nature of such annotations, and initial presentation of the kinds of progressive liberalization undertakings that may be pursued by participants. The indicative agenda stipulated the completion of work on a draft framework (with submission to a legal drafting group) including consideration of a first set of sectoral annotations by July 1990.

E. Proposals for a multilateral framework

Beginning in late 1989, and especially after the resumption of negotiations in early 1990, a number of delegations submitted draft texts on a multilateral framework to the GNS including those by the United States, by Brazil, by Switzerland, by the EC, by Japan, as well as two joint proposals, by 11 Latin American countries members of SELA, and by 7 other developing countries.

The various proposals submitted on the elements of the multilateral framework can be seen to fall within a spectrum which had at one extreme a strict initial set of multilateral obligations providing for across-the-board access commitments, including national treatment from which countries would invoke sector-specific individual reservations (i.e. "negative list"), at the same time abiding by the general obligations in the accepted sectors with very few reservations. This approach, which could be described as a "marriage" of OECD and GATT frameworks for liberalization of trade in services, is best exemplified in the United States' proposal. At the other end of the spectrum is the model constituted by a multilateral framework of very general obligations within which specific market-access objectives would be negotiated in a long-term process along the lines of the GATT itself.

This approach is followed notably in the proposal by the 7 Afro-Asian countries mentioned above.[21]

The United States' proposal provided for "market access" in the form of permanent establishment accompanied by national treatment and cross border provision of services. Concerning temporary entry for service providers (in other words labour) only temporary entry of senior managerial personnel who fulfill the requirement of essentiality would be allowed. Whereas the proposal provides for automatic temporary entry of senior managerial personnel essential to the provision of a covered service, for other types of service personnel, the relevant article only stipulates that to the extent feasible and taking into account national objectives, parties to the agreement should apply their laws relating to the entry and sejourn of aliens, in a manner that facilitates temporary entry for the purpose of providing a covered service. It was observed that the proposed agreement, failed to provide for symmetry between the treatment of capital which may permanently establish itself and labour which is limited to highly skilled, temporary and essential.

Other substantive obligations of the United States' proposal include national treatment which is automatic upon the grant of market access and excludes possibility of granting preferential treatment to domestic providers for developing countries on the basis of national policy objectives and development concerns. The exceptions provided for are government procurement and governement aid. The provision on exclusive service providers and monopolies mainly targets government providers of services and provides that all services even those not covered by the agreement should grant national treatment for all the services offered by them. This article also provides for compensatory adjustments when a party, after entry into force of the agreement, grants exclusive or monopoly privileges regarding a covered service. The article

21 The "negative list" approach is that market access and national treatment commitments would be granted across-the-board for some selected sectors, with the possibility of qualifying commitments through reservations, qualifications, and limitations. The "positive list" approach provides that participants would select sectors, sub-sectors or transactions that are commensurate with their level of development and national policy objectives for progressive liberalization, therefore the grant of market access and national treatment is not automatic but is arrived at through negotiations.

on domestic regulation does not distinguish between the developed and developing countries and the asymmetry in their regulatory systems.

The United States proposal contained certain important deviations from the principles of non-discrimination and universal coverage in that it provided for annexes, protocols, special agreements and annotations to fulfill the following aims:

- annexes to interpret and apply the provisions of the agreement;
- protocols limited to those parties ready to take up additional and expanded liberalization with respect to specific covered services;
- separate special agreements with regard to services not covered by the multilateral framework agreement, applicable only among parties to such special agreements.

Other proposals submitted by the developed countries such as the EC, Japan and Switzerland similar in overall philosophy differed from the United States proposal in that they were based on the principles of unconditional MFN and universal coverage.

With respect to development concerns, the framework proposals submitted by developed countries reflected their position that, although the special needs of developing countries should be taken into account, the principles and rules should apply equally to developed and developing countries. They argued that liberalization would automatically lead to the development of strong and competitive service sectors in developing countries, and that development aspects should be included in the framework in the form of preambular language or guidelines rather than in the form of legal obligations.

The developing countries had outlined the main principles of their position in the following terms:

- The multilateral framework should be constitutionally separate from GATT;
- Participation of developing countries should be based on the principle of relative reciprocity;
- There should be symmetry with respect to the liberalization of services delivered through movement of capital and movement of labour;

- The paramount goal of the framework should be the growth and development of developing countries;
- National policy objectives should be respected, standardization of national laws and regulations should not be sought, and the domestic services capacity should be enhanced;
- The framework should contain an unconditional MFN principle and derogations from the MFN should be provided in exceptional cases, such as for the regional co-operation arrangements for the developing countries;
- Market access and national treatment commitments should not be an inherent obligation of the framework agreement but the result of specific and separate commitments;
- Sectors of interest to developing countries should be negotiated on a priority basis;
- Transparency provisions similar to Article X of GATT should be included; and
- The process of progressive liberalization should be linked to transfer of technology.

These were transformed into specific draft texts of framework agreement, including two joint proposals. As noted above, on 26 February 1990, a proposal contained a draft multilateral framework for trade in services was submitted by a group of 11 Latin American countries (Brazil, Chile, Colombia, Cuba, Honduras Jamaica, Nicaragua, Mexico, Peru, Trinidad and Tobago, and Uruguay), an initiative which had specifically been requested by the SELA Ministers.[22] On 4 May 1990, seven African and Asian countries (Cameroon, China, Egypt, India, Kenya, Nigeria and Tanzania) submitted a "Multilateral Framework of Principles and Rules for Trade in Services". Both these submissions incorporated most of the above-mentioned elements in the form of legal obligations. The structure of the " Afro-Asian" text[23] has considerably influenced the draft multilateral framework presently under negotiation. The Afro-Asian text makes a clear distinction between what is of a general mandatory character - obligations and commitments of the parties that would be applicable to all sectors and

22 MTN.GNS/W/95.

23 MTN.GNS/W/101.

signatories upon entry into force of the Agreement - and the market access and national treatment principles which are to be implemented through the negotiations of specific concessions at the sectoral and sub-sectoral level and incorporated in Schedules of Concessions. In the Afro-Asian submission, the development objective is clearly included in Chapter II that contains the obligations and commitments of the parties and elaborated further throughout the text, with the objective of avoiding an approach similar to GATT Part-IV, where undertakings with respect to developing countries are of an exhortative character only. In the draft framework the developing countries, therefore, have managed to ensure that the structure of the agreement would clearly separate general obligations that would be accepted by all parties upon their signature of the framework (e.g. increasing participation of developing countries, MFN, transparency, etc.) in a different chapter from the market access and national treatment concessions which would be the subject of specific negotiations. The notion that developing countries undertaking liberalization in service sectors of interest to developed countries should obtain reciprocal access concessions in sectors of export interest to them has also found its way into the draft framework agreement. Market access and national treatment are not general obligations but would be the subject of negotiated commitments on a sectoral or sub-sectoral basis. Market access would result from these individual commitments to be the subject of rounds of negotiations, in pursuance of long-term process of progressive liberalization. National treatment would be the subject of negotiation and would not be automatically granted pursuant to market access.

Another main issue which faced the GNS with respect to structure was the difference of views between the proponents of across-the-board access commitments, subject to reservations (i.e. comparable to the approach followed in the OECD) which is a negative-list approach, and that of developing countries, which favour a "positive-list" of concessions comparable to Article II of GATT. The first submission that embodied the positive-list approach was the communication by Singapore on the structure of a service agreement. The paper stipulated that the structure should permit participants to offer sectors/transactions that are commensurate with their level of development and national policy objectives, therefore they should have the right to select sectors or transactions for progressive liberalization, and

not be compelled to offer sectors which are incompatible with their national and developmental objectives. This approach envisaged the following: each participant would make its initial offers of sectors/transactions; further concessions could be exchanged through bilateral requests/offers; the final individual schedule of offers would be subject to the operation of framework concepts/principles, but with indication of conditions of market entry (e.g. surcharges, number of foreign suppliers, etc.) specific exceptions, and other operating conditions after market access is granted; whatever that does not appear in individual offers schedule would not be open to progressive liberalization; the country offer schedules would be implemented on an MFN basis; and there should be a minimum threshold of individual intial commitments or offers. To permit the increasing participation of the developing countries, Singapore proposed, that the framework agreement should allow for flexibility for developing countries to develop their domestic services capacity including the capacity to export services. These facilities could include: a longer time period to implement their offer schedules; preference for domestic service providers over external suppliers, government incentives to develop their domestic services; and safeguard provisions against corporate practices of external service providers which may be detrimental to the development of domestic services.[24]

Given the asymmetry in the situation of developed and developing countries in world trade in services, the Afro-Asian submission stressed that a balanced solution would permit the developing countries to strengthen their service sectors and to acquire the ability to penetrate world markets for services. The asymmetry could also be mitigated by matching any provision for free movement of capital to deliver services with that of freer movement of labour for the same purpose. The positive-list approach would imply that developing countries would only be required to accept market access commitments in return for effective access to the markets of developed countries. Developing countries could not be requested to make future concessions unless they were able to derive meaningful benefit from the framework. The Afro-Asian framework contains provisions on initial commitments and me-

24 MTN.GNS/W/78.

chanics of liberalization which provide for a positive-list approach. The inclusion of this approach in the draft general agreement is a major achievement of developing countries.[25]

The inclusion of provisions on anti-competitive activities of transnational corporations is another major area where the developing-country proposals have influenced the present text of the agreement. Although the provisions only provide for consultation and exchange of information, the inclusion of an article on the behaviour of private operators in the general obligations and disciplines part of the draft agreement represents a step forward in this direction.

At its May 1990 meeting, the GNS decided to undertake a second round of sectoral examination through holding sectoral working groups with open-ended participation on eight sectors: telecommunications, financial services, labour mobility, construction and engineering, transport, professional services, audiovisual services, and tourism. Working groups were established to discuss sectoral specificities and to determine whether the particular characteristics of the sectors warranted a specific "annotation" to clarify the application of general principles or to provide for certain derogations from them. Should an annotation be needed, the groups were to identify the provisions that should be annotated and suggest, to the extent possible, the nature and content of such an annotation in relation to the specific provisions of the framework involved. Since early June 1990, therefore, negotiations were held at two levels: one related to the framework agreement while the other covered sectoral annotations.

With respect to the overall framework, the report of the Chairman of the GNS to the TNC in July took the form of a "profile",[26] i.e. a draft text of a framework containing the main substantive provisions with few square brackets, although it was made clear that the entire text was subject to further consideration, and that certain outstanding issues would have to be resolved if negotiations were to progress further. During the "summer break", developing countries prepared joint positions, particularly with respect to certain misleading sections of the July

25 For further details on the positive and negative list approaches see Section III.G below.

26 MTN.GNS/35.

text, which concealed a negative-list approach. In late August, the GNS decided to target completion of work on a full text of a multilateral framework of principles and rules with possible annotations for individual sectors to be made available for consideration by 21 November 1990, and the developing countries were sucessful in eliminating the misleading language of the TNC text.

With respect to sectoral annotations, the working groups' deliberations revealed certain common aspects, particularly the weakness of the position of developing countries due to financial, technological and infrastructural factors. The developing countries pointed out the following needs: to pursue their national trade policy objectives and enhance their national service capacity; to have access to technology, information, training facilities and finance; to have access for their labour services to the markets of the developed countries; and to gradually liberalize, according to their national policy objectives.

In September 1990, the GNS agreed that an open-ended *ad hoc* working group consisting of GNS negotiators and sectoral experts should meet from the second half of October, to take stock of the situation in the light of the conclusions reached in the working groups, and to finalize the draft texts of annexes or annotations where these appeared necessary. The discussions in the Ad hoc Working Group highlighted the lack of consensus amongst the participants, in particular with respect to universal coverage and the application of MFN. While there was agreement that tourism and professional services sectors did not require annotation, the discussions on telecommunications, financial services, transport, labour mobility, construction and engineering, and audiovisual services were inconclusive, mainly because some countries were unwilling to accept the application of some basic principles (in particular MFN) to some or all of the activities in these sectors. On financial services for example, there was an attempt by some developed countries to include as a sectoral annex a self-contained financial services agreement which would exclude the sector from the overall agreement on services and would involve an instant accord on timetables to liberalize financial services and a standstill on existing regulations. The annex, moreover, was intended to ensure that there would be no trade-offs or cross-retaliation between financial services and other service sectors nor between goods and services, while

providing for sectoral reciprocity.[27] This is in sharp contrast to the demand of the same countries for cross-retaliation which would extend to in goods, services, intellectual property rights, investment, etc.

F. The Brussels Ministerial Meeting and aftermath

The Ministerial Meeting held in Brussels in December 1990 to conclude the Uruguay Round collapsed principally because of differences between the European Community and the United States on agriculture. The Brussels meeting had before it a draft General Agreement on Trade in Services submitted by the Chairman of the GNS on his own responsibility, which contained draft annexes on maritime transport services, inland waterway transport services, road transport services, air transport services, basic telecommunication services, telecommunications, labour mobility, audiovisual, broadcasting, sound-recording and publishing services, guidelines and recommendations for negotiations on initial commitments, and a text of a format for schedules of initial commitments. Two proposals with respect to an Annex on financial services were submitted during the Brussels meeting.[28] All the above-mentioned texts submitted to the Ministers at Brussels were laden with square brackets. However, at the Brussels meeting some countries appear to have indicated that they would be prepared to withdraw certain reservations, thus permitting agreement to be reached on the multilateral framework. In particular, the United States agreed to drop its reservations with respect to unconditional MFN treatment and universal coverage, if the offers of initial commitments indicated a willingness on the part of the main participating countries to make concessions in a wide range of sectors of interest to

27 Sectoral reciprocity in banking services is a legal requirement (see A. Cornford, "The Multilateral Negotiationson Banking Services: Context and Selected Issues", UNCTAD Discussion Papers, No. 39, April 1991 and R. de C. Grey, "'1992', Financial Services and the Uruguay Round", UNCTAD Discussion Papers, No. 35.

28 Canada , Japan, Sweden and Switzerland proposed an annex on financial services (MTN.TNC/W/50) to serve as a basis for discussions at the Ministerial Meeting. The proposed annex was a self-contained agreement which would exclude the sector from the overall framework and would involve an instant accord to liberalization of financial services and a standstill on existing regulations. Malaysia on behalf of the SEACEN countries also submitted an annex which formed an integral part of the framework and elaborated on its provisions. The annex was based on the overiding importance of prudential considerations, monetary policies and national developement objective (MTN.TNC/W/52).

the United States. The "Green Room"[29] negotiations in Brussels apparently resulted in a text of the draft agreement which has fewer brackets and most importantly, contains unconditional MFN and universal coverage.

It was agreed at the TNC meeting of 26 February 1991 to resume negotiations on services on 8 April 1991 to discuss the following main subjects: schedules of commitments; implications of a services framework agreement on other Uruguay Round negotiations; elaboration of a more detailed indicative list of services sectors and subsectors than was presented by the GATT Secretariat in 1989; investigation of the horizontal effects of existing bilateral and multilateral agreements on services; and presentation of an indicative timetable for future work; and identification of specific tasks. Since the resumption of negotiations, the developed countries appear to be attempting to reopen many basic provisions of the draft agreement such as the balance of rights and obligations in the different parts of the agreement, the distinction between market access and national treatment, dispute settlement mechanism (i.e. linking services with goods despite the agreement at Punta del Este), and the negotiation of intial commitments. On 25 April the TNC agreed on the new negotiating structure and chairmen for the next phase of the Uruguay Round. It was decided that the GNS would continue with its structure and chairman. The first formal meeting of the resumed GNS was held from 27 May to 6 June 1991 on the assumption that the negotiations would be concluded by the end of 1991. The meeting discussed matters relating to: scheduling of commitments, classification of services, initial offers tabled so far by participants, guidelines for the conduct and finalization of the negotiations on intial commitments, horizontal agreements, framework issues (dispute settlement, domestic regulations, definition of terms). The GNS is scheduled to meet 24 to 28 of June and 15 to 19 of July 1991 to discuss scheduling of specific commitments, considerations relating to Article I, matters relating to labour mobility, substantive and procedural guidelines for the negotiation of initial commitments, considerations to be taken into account when assessing offers. Other outstanding matters that will be discussed are matters relating to MFN and how concerns of individual

29 These are informal meetings chaired by the Director General of GATT to which a restricted number of countries are invited.

participants can be met without resorting to widespread derogations from this important principle. Matters relating to both horizontal arrangements (e.g. bilateral investment treaties and friendship commerce and navigation treaties) and techniques for dealing with sectoral considerations, "illustrative lists" of the sorts of non-discriminatory measures that should be included in the Schedules, any special arrangements for those sectors which require an annex, and improving the quality of offers through requests procedure also need to be addressed.

III. THE OUTSTANDING ISSUES IN THE NEGOTIATION OF THE MULTILATERAL FRAMEWORK

A. Structure

The overall structure of the multilateral framework[30] has become a question of crucial importance. There would seem to be agreement, as is demonstrated by the structure of the Brussels text, that the structure of the agreement should clearly separate general obligations that would be accepted by all parties upon their signature of the framework (e.g. MFN, increasing participation of developing countries, transparency, etc.) from commitments with respect to market access and national treatment which would be the subject of specific negotiations, and included in schedules of concessions. This is considered essential by developing countries, as it would mean that their subscription to the framework would not, in itself involve access in particular sectors; which would be the subject of negotiations where they could offer access commitments with respect to those sectors or sub-sectors in which liberalization would be consistent with their development strategies. By including a clear obligation on "increasing participation of developing countries", the developing countries would obtain a recognition in the framework of the basic "asymmetry" in the situation of services in developed and developing countries and a commitment that the developed countries would take concrete measures aimed at strengthening the domestic service sectors of developing countries and providing ef-

30 The latest draft is entitled "General Agreement on Trade in Services" which leads to the unfortunate acronym "GATS" - hopefully this will be changed as the audible difference between "GATT" and "GATS" is indiscernable enough to confuse debate.

fective market access for their exports, while the developing countries themselves would pursue this objective through the imposition of conditions on access for foreign suppliers. It should also permit developing countries undertaking liberalization in service sectors of interest to developed countries to obtain reciprocal access concessions in sectors of export interest to them.

B. Scope/Definition

In the Brussels text, some questions relating to scope and definition which would seem essential to the acceptability of the framework for developing countries have been left unanswered. The essential criterion for an acceptable definition of trade in services included in the Montreal text was that movement of factors of production could be considered as trade in services only when occurring "under conditions of specificity of purpose, discreteness of transactions, and limited duration" thus implying that immigration and investment would not be covered. This is clearly contained in the developing-country proposals, which provide for the following points: that "cases involving permanent establishment, foreign direct investment or international immigration shall not be covered by the definition of trade in services"; and that "factors of production are to be treated symmetrically in the framework and in the negotiations", i.e. that services delivered through movement of persons should not receive a less degree of liberalization (at least with respect to the economic impact) than those involving capital flows. The Brussels text article I.2.(d) on commercial presence contains a square bracketed text which provides that "the provision of the service being for a limited duration and a specified purpose.", which means the issue of right of establishment and foreign direct investment is still left open. It is clear, that for many services, developed countries will be seeking concessions with respect to "commercial presence", which is reflected in the offers they have submitted.

With respect to the scope of the framework, developing countries have maintained that all tradable services should be covered, a position shared by the EC and most developed countries. However, the United States and some others have taken the position that countries should have the right to exclude sectors. If exclusions were to be permitted, each country would exclude those sectors where strong political oppo-

sition to liberalize existed, rendering the multilateral framework virtually meaningless. The Brussels text now conforms to the position of developing countries by providing that the agreement applies to measures affecting trade in services which means that all tradeable services are included. An attempt has been made to deal with specific problems through sectoral annexes which contain derogations to the MFN clause.

C. Most-favoured-nation treatment

The major decision which has to be taken concerning the Brussels text relates to whether most-favoured-nation treatment[31] is to be treated as a general obligation to extend the benefits of any measure on trade in services from any country to all parties, an approach supported by the overwhelming monopoly of participants. The annexes included in the Brussels text, as well as most of the offers of concessions made, are drawn up on the assumption that the agreement would include an unconditional MFN clause. If this assumption is maintained, a decision will have to be taken on the scope of the derogations from MFN which are reflected in the draft annexes.

The preservation of the unconditional most-favoured-nation principle would seem essential. Exceptions to the general most favoured national treatment have been sought for several reasons such as for: (a) maintaining the status quo through grandfathering of existing preferential and other agreements i.e. analogous to the Commonwealth preferences recognized in GATT Article I on MFN; (b) permitting exemptions from commonly agreed objectives and subject to multilaterally-agreed criteria i.e. economic integration agreements

31 On further details on the MFN clause see Committee on Finance of the United States Senate, The Most-Favoured-Nation Provision, Executive Br anch, GATT Studies No.9, 93rd Congress, 2nd Session (Washington: U.S. Government Printing Office, 1974). See also the First Report of the special Rapporteur, Endre Ustor to the International Law Commission (ILC), Yearbook of the International Law Commission, 1969, Vol. II, Doc. A/CN, 4/213, UN 1970. The second report of the ILC Yearbook, 1970, Vol. II, pp. 199-242, deals with the jurisprudence of the International Court of Justice in respect of the MFN clause and with the role of the MFN clause in areas other than international trade and in international trade, including the GATT. In ILC Yearbook, 1973, Vol II, pp. 117-53 there is a digest of decisions of national courts relating to the MFN clause. The ILC Yearbook, 1978, Vol. II, Part two, contains the text of 30 draft articles which set out a resolution of the ILC to form the basis of a resolution of the United Nations General Assembly.

which provide for a higher degree of liberalization of trade i.e. analogous to the GATT Article XXIV and its enabling clause, or for reasons peculiar to certain services such as cultural considerations; and (c) exclusion of sectors or sub-sectors as a tactic to increase a country's negotiating position. While the first two reasons may be considered "legitimate" if subject to multilaterally-agreed criteria, derogations whose effect would mainly be to gain advantages in the negotiations would undermine the functioning and credibility of the multilateral framework.

As noted below, some proposals by the developed countries, related to sectoral annotations, as aimed at qualifying the MFN obligation in certain sectors and even permitting special limited agreements applied on a conditional basis in others. The pressure for sectoral reciprocity is in conflict with the unconditional MFN clause. The most important feature of the proposed framework agreement is that by bringing all services under the same framework, rather than a series of "stand alone" sector agreements, it permits cross-sectoral trade-offs, compensation or retaliation as between service sectors. It must be noted that sectoral reciprocity makes no more sense in services than it does in trade in goods, it is in complete contradiction with the concept of comparative advantage. Developing countries would be required to engage in a mutual liberalization process in sectors where they do not possess comparative advantage, without being compensated by receiving access in sectors, or modes of delivery where they do possess such advantage. For this reason any qualification of the unconditional MFN clause (especially through a sectoral specific agreement on financial services) is strongly opposed by developing countries.

The issue of "grandfathering" of existing arrangements and relationship between the existing international agreements dealing with services and the framework agreement would have to be addressed. It should be recalled that the GATT in its Article I recognized the existence of certain preferential arrangements, but this recognition was based on the principle of "no new preferences",[32] and the expectations that preferential margins will be eroded in future negotiations.

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32 see discussion of Sectoral Annotations below.

Article V of the Brussels text recognizes that regional integration arrangements could provide for a greater degree of liberalization than that extended on an MFN basis, and that provision would be made for preferential agreements among developing countries, as well as for preferences in favour of developing countries, along the lines of GATT Article XXIV and the enabling clause. While the unconditional MFN obligation would cover all trade in services, whether or not included in the Schedules of Concession, Article II:4 provides that the existing presence of suppliers in the market shall not subsequently require the host party to permit the presence of services providers of other parties in its territory on the same terms.

As discussed separately, most of the proposed sectoral annexes are intended to provide for derogations from MFN. Recently there have been proposals that such derogations could be invoked by individual countries with respect to specific sectors and arrangements. In dealing with issues the considerations taken above should be taken into account - particularly the "no new preference" principle, and that no derogation from MFN should be such as to strengthen the negotiating position of the derogating country.

D. Increasing participation of developing countries

The need for the multilateral framework to provide for the increasing participation of developing countries in world trade in services and the expansion of their services exports, for the strengthening of their domestic services capacity and for extending them effective access to markets was recognized at the Montreal Mid-Term Review and the Brussels text. The question has arisen as to how such provisions could be incorporated into the framework as legally binding obligations. Developed countries have argued that these endeavours should take the form of preambular phrases or declarations of intent but not contractual obligations. Developing countries have recalled that at Punta del Este it was clearly recognized that the development of developing countries was one of the primary objectives of the framework. The framework should, therefore, serve to provide for concrete measures both by the developing countries themselves and by developed countries, which clearly dominate international trade in services, to enable developing countries to increase their share of the world market.

The importance of the framework containing clear principles on increasing participation of developing countries is to remove any doubt regarding the legitimacy of measures taken by developing countries to strengthen their services capacity, such as imposing transfer of technology or access to network conditions on foreign services suppliers, or to apply other national policy measures for this purpose, including subsidizing their services sector. In providing access to their markets for foreign service suppliers, developing countries have stressed that they would attach conditions to access such as: limitations or requirements with regard to the type of commercial presence; minimum requirements for training and employment associated with different stages of producing the service; surcharges and different tax rates; local content requirement; access to technology; information regarding global business operations; and provision of financial resources.

Developing countries are also seeking that the obligation to provide developing-country service suppliers with effective access to markets be laid out in specific terms. As the export potential of many developing countries depends largely on the liberalization of cross-border movement of personnel covering the entire spectrum of skills from unskilled or semi-skilled to high-skilled professionals, developing countries have sought recognition that the developed countries should liberalize their national regimes so as not only to enable developing country firms supplying services abroad to recruit personnel from their own domestic sources, but also to permit service firms to recruit personnel from the source which is economically most advantageous. With a view to accomplishing the objective of increasing participation of developing countries and to facilitate effective market access for services exports of developing countries, they have sought that the developed countries accept to take the following specific measures:

- Establish enquiry points to provide exporters from developing countries with commercial information;

- Establish contact points to assist developing-country exporters with questions relating to registration, recognition and completion of professional qualification, obtaining such qualifications in cases of lack thereof;

- Grant preferential market access to developing countries Parties' exports and/or exporters of services;

- Prohibit measures and practices that limit or impede access to information networks and to distribution channels for services;

- Eliminate measures that impede or limit free choice in the acquisition of technologies, as well as those that restrict access to such technologies;

- Facilitate training programmes for local personnel and the exchange of personnel of developing countries; and

- Promote the participation of national suppliers from developing countries in the research and development activities conducted by foreign suppliers. The provisions of the framework should not prevent developing countries from providing incentives to strengthen their domestic and export services capacity and take necessary measures to secure a minimum level of domestic production.

The Brussels text contains a general statement of good intentions in its Article IV, but falls short of a binding obligation with respect to action by the developed countries. This Article provides that the developing countries' participation in world trade should be facilitated through specific commitments by different parties pursuant to Part III (specific commitments) and Part I (progressive liberalization) of the agreement relating to *inter alia*: strengthening of their technological capabilities (references to technology are square bracketed) and their domestic services capacity and its efficiency and competitiveness; the improvement of their access to technology and to distribution channels and information networks; and the liberalization of market access in sectors and modes of delivery of export interest to them. This Article also provides for the establishment of contact points to facilitate access to information on commercial and technical aspects of the supply of services; registration, recognition and obtaining of professional qualifications; and the availibility of service technology. Part IV (progressive liberalization) of the Brussels text in its Article XVIII on negotiation of commitments provides for a paragraph stipulating that the process of liberalization should take place with due respect for

national policy objectives and the level of development of individual parties, with appropriate flexibility for individual developing countries for opening fewer sectors, liberalizing fewer types of transactions, progressively extending market access in line with their development situation and, when making access to their markets available to foreign service providers, attaching to it conditions aimed at achieving the objectives referred to Article IV.

The ways and means to make Article IV operational will be discussed further, in particular in the negotiations of specific commitments and the imposition of conditions on market access and national treatment, since from the initial offers as they stand, it is not obvious that many concessions of value to developing countries are yet on the table, particularly when the exceptions to MFN and the lack of offers on the movement of personnel as a mode of delivery are taken into account. The question of transfer of technology is of utmost importance in the development of services capacity. In the services negotiations, it is in part the obverse of the labour mobility issue. Developing countries need to ensure that, if they are to agree that foreign-controlled entities may be established in some sub sectors, and if they are to agree to the temporary entry of key personnel for such entitites, efforts will be made to train local personnel and that they be treated, in regard to salaries, promotion, pensions, etc., on a non-discriminatory basis. Of course, this is no more than good business practice. It is unlikely to prove easy to incorporate in individual country sub sector lists of commitments the various conditions that it may be proposed to attach regarding measures to ensure adequate transfer of technology (although the employment of local personnel is certainly an element). Nor are the statements of good intentions in proposed Article IV adequate to this task. Accordingly, developing countries may wish to consider some sort of working group on technology transfer in the services industries, which would look in detail at know-how, licencing, franchising, etc.; this group might attempt to draft a detailed Annex, or to rewrite Article IV; *ad interim*, any initial commitment offered by a developing country might well be covered by a general statement that *all* market access undertakings are to be subject to such conditions regarding technology transfer as may be agreed, in general, or in regard to particular service sub-sectors.

E. Monopolies and exclusive service providers/Behaviour of private operators

Some developed countries have sought strict conditions on the operations of monopolies which may extend even beyond the scope of the schedules of commitments. On the other hand, they have resisted comparable provisions with respect to the treatment of RBPs and other anti-competitive practices of private corporations. Developing countries fear that if the framework were to contain weak provisions in this respect, it would be interpreted by enterprises as a clear indication of the lack of determination by governments to deal with anti-competitive practices. Thus, the developing-country proposals aim at imposing obligations on all parties to take all possible measures, by legislation or otherwise, to ensure within their jurisdiction that service suppliers do not engage in unfair trade practices, to establish international standards and disciplines for the control of adverse trade effects of anti-competitive private- sector behaviour, and multilateral mechanism to enforce such standards and disciplines. The prevalence of anti-competitive practices has been noted elsewhere in this volume and in earlier publications by UNCTAD.[33]

Whereas the Brussels text contains very strong provisions on monopolies and exclusive providers stipulating *inter alia* that:"Each Party shall ensure that any monopoly provider of a service in its territory does not, in providing the monopoly service in the relevant market, behave in a manner which would nullify or impair benefits to which service providers of other Parties are entitled...", on behaviour of private operators the text only provides for consultations, cooperation and exchange of information. It would seem essential that there be a clear obligation for the control of anti-competitive practices, as contained in article 13 of the Afro-Asian text and article 7 of the Latin-American text which provide that parties should take all possible measures, by legislation or otherwise, to ensure, within their jurisdiction, that service suppliers do not engage in unfair trade practices and that international standards and disciplines for the control of

33 See P. Brusick, M. Gibbs, M. Mashayekhi, "Anti-competitive Practices in the Services Sector" in *Uruguay Round: Further Papers on Selected issues* (United Nations Publication, UNCTAD/ITP/42), pp. 129-56.

adverse trade effects of anti-competitive behaviour, and a multilateral mechanism to enforce such standards and disciplines should be established.

F. Subsidies

While developing countries need flexibility in using subsidies to improve their domestic capacity for production of services, they would have a clear interest in a total prohibition on subsidies by developed countries. Some developing-country proposals provide for a standstill and rollback on subsidies of developed countries and flexibility in the use of subsidies by developing countries to achieve specific objectives. The Brussels text recognizes that,in certain circumstances, subsidies may have distortive effects on trade in services and provides that future negotiations should take place with a view to developing the necessary multilateral disciplines to avoid such trade distortive effects. The text also provides that the future negotiations or diciplines should recognize the role of subsidies in relation to the development programmes of developing countries and take into account the needs of parties, particularly developing countries, for flexibility in this area.

There is not much published information related to subsidies on services although it is clear that some services sectors are highly subsidized. Again it would be important to avoid those aspects of GATT's treatment of subsidies which have given rise to confusion and abuse. While the reduction and elimination of trade-distorting subsidies could be an eventual objective, it would be important to define, from the beginning, the legitimate objectives of subsidies in services (e.g. to assure a minimum level of services to the population, national security, cultural and environmental protection). It would also be dangerous to provide signatories with the right to take unilateral countervailing measures, given the experience with countervailing duties on goods (which would be potentially open to even greater abuse in the services sector).

G. Negotiation of commitments/Progressive liberalization

Developing countries have stressed that the ideas of gradualness and long-term progressive liberalization need to be clearly reflected in

the framework and any allusion to graduation should be excluded. Progressive liberalization should include the essential concept that liberalization should proceed for the identification of the adverse trade effects of laws, regulations and administrative practices, as provided in the Montreal text (paragraph 7 (b)). Its inclusion would ensure that requests for liberalization by developed countries were not based on mechanical criteria for the evaluation of offers, but focused on measures where specific trade effects would be clearly identified. With respect to the time limit for further negotiations, such a period should take into account the interest of developing countries and the work programme (for example, for elaborating a statistical basis and implementing transparency provisions). A longer time limit for further negotiation may therefore be required to effectively evaluate the benefits developing countries have gained. It should also be recognized that developing countries should not be asked to adopt liberalization measures which would conflict with their developmental and technological objectives, and that progressive liberalization by developing countries would be governed by the actual expansion of their service exports, not judged on hypothetical market opportunities, which they might not be able to translate into concrete benefits.

The provisions on progressive liberalization are of fundamental importance. As explained above, developing countries have stressed that the provisions for future liberalization should be based on a positive-list approach, which has been incorporated into the draft framework. Liberalization would be achieved through the inclusion and progressive addition of sectors and sub-sectors to the schedules of concessions which would lay out where parties would agree to provide market access and national treatment. The positive-list approach is seen as possessing clear advantages over a framework under which developing countries would be required to submit "reservations" with respect to sectors or transactions that they would not be prepared to liberalize immediately. The latter approach would imply that they would be immediately placed on the defensive, i.e. under pressure to liberalize access to their markets for services unilaterally, whether or not they were able to benefit effectively from the multilateral framework and the liberalization by developed countries in terms of increased exports and market penetration by developing-country enterprises.

Developing countries viewed the negative-list approach as reflecting the situation in which, for technological, financial and market-power considerations, developing countries will be able to gain little from market access in developed countries; and as such it would be difficult for them to convince developing countries to liberalize without giving them special additional concessions. The negative-list approach could tempt more powerful countries to pursue progressive liberalization of developing-country service markets through exerting pressure to remove reservations rather than offering developing countries meaningful concessions and benefits. Binding at the outset the current level of market access and entry conditions, in accordance with Article XIX of the Brussels text, complements the "reservation" approach. In fact, it could imply that parties would be accepting the right of establishment and national treatment, and temporarily reserving their position with respect to the immediate application of such principles.

There were also fundamental technical reasons for advocating in favour of the positive-list approach, as it would be impossible for most developing countries (which, unlike OECD countries, have not had decades of experience in this respect) to determine which laws, regulations and administrative guidelines would come under the scope of the agreement and thus (according to the negative-list approach) be subject to market access and national treatment obligations. This would have caused legal and constitutional problems as it would be extremely difficult to convince legislatures to apply such an agreement, given the serious but unclear implications for a wide variety of existing legislation. Also, faced with such a dilemma, most developing countries would likely have found themselves in a postion of having to submit virtually "blanket" reservations, which would give rise to accusations that they were not making an acceptable level of commitment and would provoke resort to non-application clauses. Moreover, in future negotiations they would find themselves on the defensive, being submitted to a justification rather than bargaining process. Not only would this make it difficult for them to achieve reciprocity in future rounds of negotiations, but it could also provoke bilateral pressures of the "Section 301" type on the basis that the developing countries in question had maintained too many reservations or for too long.

The Brussels text contains a "hybrid" approach to the formulation of the schedules of commitments. Those sectors which are subject to commitments are listed in a positive manner,[34] obligations with respect to market access and national treatment exist only for those sectors included in the list; any limitations and conditions on market access and any conditions and qualifications on national treatment are to be inscribed in the national schedules in a negative manner i.e. stating where market access (for the four modes of delivery) and national treatment is "unbound", in that no obligations have been accepted or where special limitations or conditions apply. The structure of the proposed schedules is necessarily more complicated than the GATT schedules, in that, once a sector or sub-sector has been included in the list of concessions, the obligations with respect to market access and national treatment, regarding each of the four modes of delivery of a service to a market are to be specified negatively, that is, in terms of the limits and conditions regarding market access and national treatment for each of the modes, and all this in reference to the relevant structure of regulation. At this stage, it is not clear that obligations regarding access, for each of the four modes of delivery, and regarding the standard of national treatment to be accorded, can be set down with sufficient clarity to avoid potential disputes, in the format set out in the Brussels text. It may be that more detail as to the working of relevant regulatory systems for each sector should be set out in explanatory notes, or that individual signatories could will preface their lists of obligations, by sector, with definitional head-notes, along the lines of those that have been employed in the CCCN, and some of which have been set out in GATT schedules.

H. Market access and national treatment

The structure of the Brussels text provides that market access and national treatment provisions are not obligations, but are exchanged as negotiated commitments, with respect to individual sectors or subsectors. Market access commitments would be negotiated in accordance with the definition of trade in services, and foreign suppliers could be obliged to accept obligations as described above under increased

34 "Positive" and "negative" are described as "bottom up" and "top down" respectively in current jargon.

participation of developing countries as a condition for access to markets, specifying that the modes of delivery would be individually negotiable. The developing countries are seeking to ensure in the future negotiations that market access is not made dependent on reciprocal concessions within the same sectors, so that parties could seek liberalization in those sectors and sub-sectors where they possessed comparative advantage and grant concessions in those sectors where liberalization was judged most compatible with their economic, social and development interests. Such an approach would mean that, as was the case in goods under the GATT, negotiations could address those sectors where liberalization was less difficult and thus quickly consolidate the legal structure of the framework. Given the negative approach in listing limitations, conditions and qualifications to market access and national treatment, developing countries need to ensure that the framework does not provide for the recognition of any "right" to market access and national treatment, but that developing countries' commitments with respect to market access and national treatment would be confined to those sectors and sub-sectors where they would agree to specific concessions, and that symmetry should be maintained between the treatment of movement of factors of production - i.e. capital and labour - associated with the supply of services. The Brussels text in its Article XIX on application of the agreement provides in its paragraph 3 (which is in square brackets) two alternatives. The first alternative provides for the binding of market access and national treatment at levels included in the schedule of commitments. The second alternative goes even further in binding with respect to all sectors the existing level of market access and national treatment. The developing countries are opposing the second alternative (i.e. the "freeze") on the basis that they consider that it would make the multilateral framework simply a device for consolidating the already dominant position of the developed countries in international trade in services.

I. The relationship of existing arrangements with the future framework

As has been noted elsewhere in this volume, many aspects of trade in several sectors are already governed by multilateral agreements. The choice to be made is between supremacy or equality of the frame-

work agreement with such sectoral arrangements. There seemed to be no disagreement among participants in accepting the idea of *complementarity* between the framework agreement and the existing sectoral disciplines. This complementarity, however, was viewed differently by different participants. The EC has referred to the role of the IMF, to OECD Codes and to the need for co-operation between GATT and the other existing arrangements, and emphasized the fact that technical questions should be left to the existing arrangements. Some others believe that the primary objective of the existing arrangements is not liberalization but standardization, pooling of resources, and allocation of markets. The purpose of the multilateral framework, however, would be to gain market access and liberalization.

The complementarity between the future framework and the existing arrangements is important and sectoral annotations could be one way of dealing with the interrelationship question. The Brussels sectoral annexes such as the maritime transport annex and the air transport annex do refer to the existing arrangements (i.e. Code of Conduct on Liner Conferences and the Chicago Convention) and their review or phasing-out. The developing countries stress the need to study the impact of the existing bilateral and multilateral agreements, in particular the horizontal agreements on the framework agreement (for example the OECD codes of liberalization, OECD National Treatment Instrument, taxation agreements, visa and labour agreements investment treaties, and FCNs) and to draw up a list of such agreements.

J. Safeguards

Developing countries have insisted that any safeguard clause in the multilateral framework should enable them to take safeguard action not only for balance-of-payments reasons, but also to deal with adverse trade effects caused by situations of concentration of ownership, market domination and restrictive business practices (as the possibility of such situations arising might have been completely unforeseen when the market access conditions were initially negotiated), as well as to permit the creation of new capacities in services and the correction of structural problems.

Article X of the Brussels text contains two alternative drafts. One is modelled, broadly speaking, on GATT Article XIX;[35] the second varient proposes that negotiations on a safeguards clause be postponed until two years after the entry into force of the agreement. There is some concern that the question of emergency safeguards measures should not be left to be negotiated after the conclusion of the framework, as it is of crucial importance to ensure when undertaking legal obligations on progressive liberalization that safeguards are available, should it become impossible to meet these obligations owing to their injurious effect on domestic service suppliers. The manner in which the negotiations are taking place further complicates the consideration of the safeguards issue, since the initial commitments are being negotiated at the same time as the multilateral framework. In the current situation, there will be a tendency to build in self-contained safeguards into the initial lists. It would seem, however, that the main concern in drawing up a safeguard clause should be to avoid incorporating into the services framework those aspects of the GATT Article XIX which have proven unworkable or subject to abuse. Some of these might be avoided, if from the beginning there were a clear understanding as to what situations justified resort to safeguards measures and, what measures were appropriate, perhaps through an indicative list. The advisability of compensation and/or retaliation provisions would also have to be examined seriously, there is for example, possibility that such would not apply if the safeguard measures were found to conform to criteria to be drawn up in the framework. If the second option were to be adopted, a special, temporary waiver provision could be drawn up for countries wishing to take safeguard action. Negotiation of the safeguard provisions could be based on the experience gained in the operation of this waiver provision. Consideration should also be given to an article dealing with the application of quantitative limitations on the access of services suppliers, since in many services sectors these restrictions are applied to prevent injury to domestic producers and to control entry into the market, for prudential and other reasons.

35 GATT Article XIX is seen as promoting liberalization since countries will presumably make relatively more liberal offers knowing that they may resort to the escape clause, if such concessions result in increased imports to the extent that serious injury to domestic industry is incurred.

K. Dispute settlement mechanism

International agreements, both bilateral and multilateral, frequently contain provisions as to how disputes about the interpretation of such an agreement shall be resolved. Disputes arise when one party takes an action which another party regards as inconsistent with the agreement. The absence of dispute-resolution provisions, including sanctions for non-compliance with the agreement, can render an agreement ineffective. The United States has expressed the view that, with regard to services, the arrangements negotiated in the OECD, as between industrialized countries, and covering much of what is set out in the Brussels text, are ineffective because of the absence in the OECD system of effective dispute-settlement provisions.[36] It is clear that the proposed disputes resolution system (Articles XXII and XXIII) is based on the GATT articles, but not as yet interpreted and amplified by the kind of detailed procedural understandings which have filled out the GATT articles (the most recent being the proposed accord on this subject placed before Ministers at Brussels).[37] However, it is likely that such amplifications and understandings will be sought. A number of points about the proposed system should be noted. First, like the GATT system, it is self-contained - that is, it does not contemplate recourse to a dispute-settlement mechanism outside the multilateral framework, such as the International Court of Justice (in contrast to ICAO, for example, and in contrast with the arrangements contemplated in the Havana Charter). Second, compensatory or retaliatory sanctions are to be limited to those concessions negotiated under the framework, not, for example, those arising in relation to goods trade under the GATT - clearly, any such "cross-retaliation" would be against the interests of developing countries and clearly in contradiction with the Punta del Este Declaration. Third, Article XXIII (4) proposes (in square brackets) that the dispute-settlement mechanism could be used when an action by a signatory which is not inconsistent with the agreement is alleged to have "nullified or impaired" a right or advantage that another party could have reasonably expected to accrue under the

36 see R. Grey, *Concepts of trade diplomacy*, pp. 163-164. and Office of the United States Trade Representative, *US National study of trade in services*, Washington, December 1983, p.86.

37 MTN.TNC/W/35/Rev.1

agreement. This follows the GATT Article XXIII 1(b) practice closely. However, given the wide range of regulations affecting trade in services there would seem to be considerably greater difficulty in identifying situations where violation of commitments has occured. This would entail further elaboration of Article XXIII to establish concrete criteria for identifying the cases which would fall under this paragraph, otherwise the interests of developing countries could be endangered.

The "commercial presence" aspect of concessions on services introduces an additional complication peculiar to services, much more difficult to resolve in trade in services than trade in goods. That is, in services it might not always be clear as to which country has a right to invoke the dispute settlement provisions on behalf of whom. For example, if a foreign owned firm is incorporated domestically and becomes, for the purposes of national law a domestic firm, would it not have to relinquish any right to have a foreign government intervene on its behalf under the dispute settlement mechanism of the framework ? Otherwise would such firm not be receiving more than "national treatment" ? Might it not be necessary to draw up a list of firms "covered by the concessions" to distinguish them from national firms?[38] In addition, in cases where ownership is shared among various countries or where the legal incorporation of a firm is located in different country than the ownership, the problem of "origin" of the service in question would again arise.[39]

IV. SECTORAL ANNOTATIONS

The Mid-Term Review Decision recognized that sectoral specificities would have to be taken into account, and provided that before the concepts, principles and rules which comprise a multilateral framework for trade in services are finally agreed, these concepts, principles and rules will have to be examined, with regard to their applicability and the implications of their application to individual sectors and to the types of transactions to be covered by the multilateral framework.

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38 See Gibbs and Hayashi, "Overview", in *Trade in Services, Sectoral Issues*, UNCTAD/ITP/26, Geneva 1990.

39 The problem of the ownership of firms has been dealt with by the International Court of Justice in Barcelona Traction Case, I.C.J. Reports (1970).

At the core of the discussions of the sectoral working groups is the question of "coverage", i.e. whether the general trade-liberalizing principles embodied in the framework should apply to all service sectors. The solution adopted is that the "peculiar" sectors or aspects of these should be dealt with in annexes, accommodating the application of the framework's general principles to their special circumstances. The work of the groups has been hindered by the fact that at least one major country have not yet accepted that all sectors would be covered by the framework, and is seeking total exemptions for certain sectors. As noted elsewhere, most countries have made their offers conditional upon the acceptance of universal coverage of the framework and unconditional MFN treatment. In addition, until there is a final decision as to the structure of the framework agreement and as to the rights and obligations, it is difficult for participating countries to make commitments with respect to sectoral annotations.

In the discussions in the sectoral groups different reasons have surfaced for the need for sectoral annotations. The original reason has been the need to draw up an annotation to deal with the particular technical characteristics of the sector which make it difficult to apply general concepts such as market access, national treatment and non-discrimination to the sector. The most pertinent example of this is the telecommunication sector for which annexes have been formulated to distinguish the aspects of the sector as a mode of delivery and as a sector.

However, another approach has been to seek sectoral "annotations" as a means of negotiating generally agreed derogations from certain of the multilateral principles. As has been discussed above, proposals to this effect have been made with respect to transportation services, "basic" telecommunications service, and audiovisual and other media services.

A third approach[1] would aim at an "annotation" which would come very close to a separate, self-contained agreement for the liberalization of trade in the sector - "self-contained " in the sense of containing a balance of mutual rights and obligations among signatories. Proposals to this effect have been made with respect to the financial services sector. The danger of such an approach for the integrity of the overall framework is that it could lead to some signatories adopting a condi-

tional approach, i.e. extending the benefits of liberalization only to those parties to the multilateral framework which accepted the obligations of the "annotation".

A fourth approach is to define in more precise detail the "modes of delivery" aspect of certain sectors (notably telecommunications and movement of labour) with the objective of clarifying market access commitments. In this respect the inclusion and content of an annex on labour mobility are important for many developing countries, as the annex would have a bearing on the nature of commitments which might be negotiated with respect to the supply of labour services.

Most of the sectoral annexes in the Brussels text contain derogations to the MFN clause (i.e. maritime transport, road transport, air transport, inland waterway transport, "basic" telecommunications services, and audiovisuals) and two of them would in effect define modes of delivery, i.e. labour mobility and telecommunications annexes.

The annexes thus contain, in regard to major services sectors, statements that the MFN provisions are not to apply in these sectors, relating the sector provisions of the framework to the existing international agreements for these sectors, and then promising future negotiations or phasing-out. As a practical matter, exempting a sector from the MFN obligation for all signatories raises the question of in what sense the framework agreement applies to the sector. Countries taking a position in favour of excluding certain sectors from the scope of MFN could be asked to specify just what rights and obligations, *if any*, apply in regard to that sector under the "General Agreement". More specifically, why should the obligations of Article III (transparency) apply - or, for that matter, the various other obligations of Part II - if Article II (MFN) does not apply. The sectoral annexes may have to be recast or abandoned; in some form they would still be necessary - for defining sector scope, and for making clear, for example, that domestic traffic rights for the air transport sector are to remain excluded from the scope of market access and national treatment. It has recently been suggested that each signatory could specify those exceptions from mfn treatment in its own lists of initial commitments. Before the disputes over the sectoral annexes/annotations are resolved, no firm

commitments to liberalize can be expected and the completion of the framework remains in jeopardy.

A. Telecommunications

The dual role of telecommunications as a service sector in itself, and a mode of delivery for many other services is now widely appreciated,[40] deriving to a considerable extent from the insistence of developing countries on this point and the two submissions by India, Egypt, Cameroon and Nigeria.[41] The first submission, entitled "Sectoral Annotation on Telecommunication Services", addresses the scope, coverage and sectoral peculiarities arising from the application of the multilateral framework to international trade in telecommunications services. The second submission, which is an annex to the framework agreement, covers telecommunications as a mode of delivery. The purpose of this separation is to ensure that the conditions of use of telecommunication services as a mode of delivery do not impair the market access commitments made in schedules, limited by existing

40 The Telecommunications Annex of the Brussels text in its paragraph 1 on objectives provides for the recognition of the specificities of the telecommunication services sector and, in particular, its dual role as a distinct sector of economic activity and as the underlying transport means for other economic activities. For background see Russel Pipe, "Telecommunications Services: Consideration for Developing Countries in Uruguay Round Negotiations" in *Trade in Services: Sectoral Issues* UNCTAD/ITP/26, Geneva 1990.

41 See also the United States' submission of 23 March 1990 on an annex on access to and use of services of public telecommunications transport services, the purpose of which is to obligate countries to provide access to public telecommunications transport networks for the conduct of business including (it is singled out) intracorporate communications and the provision of services covered by the framework. The following provisions of the Annex are of particular interest: article 2 of the Annex provides for a broad coverage as follows " This Annex applies to any existing or new measure of a Party that relates to access to public telecommunications transport services, whether or not covered by the Framework Agreement...." Paragraph 2.5 of this article specifically emphasizes the fact that the obligations of the Annex will not imply that intracorporate communications are or are not traded. Article 3.1 provides for a broad access to and use of public telecommunications transport services "offered within or into the territory of the Party". In accordance with article 3.6.7, use of public telecommunications transport services would "include the movement, storage, and processing of information by a person within and across the borders of the Party". Article 3.7.4 has some important implications in that it would forbid the host countries to condition access by demands to obtain licenses or comply with regulation procedures "the effect" of which would be "to nullify or impair" benefits derived from the accession to this Annex or the framework agreement. The Annex also forbids in 3.7.3 to condition access by technical standards which go beyond the requirements necessary for network-harm prevention.

telecommunication capabilities. The annex does not, in itself, result in liberalization in any sector, including telecommunications, without a negotiated commitment having been included in the schedules of concessions. Moreover, use of telecommunications as a preferred mode of delivery should not imply that preferential treatment will be given to foreign entities in terms of regulations applied to a party's domestic users; nor should it imply interference with a party's determination of the technologies and equipment which will be permitted to be imported via telecommunications or operated in the domestic market in terms of compatibility with and suitability to local conditions.

Most countries generally support the need for a specific annex because of the many specificities of the telecommunications sector, in particular its importance as a distinct sector of economic activity and as a mode of delivery for other services. The United States, however, has taken the position that access to and use of public telecommunications transport networks should be obligatory for parties to the services agreement. Developing countries, on the other hand, consider telecommunications as a mode of delivery subject to limitations and conditions in a party's schedule of commitments, and the annexes necessary to take account of the dramatic "assymetry" in this sector as between developed and developing countries.

At Brussels, the Ministers had two annexes on telecommunications before them. The annex entitled "basic telecommunications services" was submitted by the United States with the objective of excluding basic telecommunications transport services and networks from MFN coverage in relation to the supply of services providers of other parties. This proposal derived from the perception that whereas the United States has privatized the basic telecommunications services sector, most other countries reserve this sector for PTT administrations and thus, the extension of any concessions on an MFN basis would deprive the United States of the ability to negotiate market access with such countries. The second annex on telecommunications covers the mode of delivery aspects of this sector as discussed below.

Developing countries' participation in telecommunications field could be increased by the allocation of financial and human resources to assist developing countries in introducing improvements in their

telecommunications infrastructures. The submission of developing countries also encourages parties to agree to give priority to the telecommunications needs of developing countries through international lending institutions and the United Nations system. The Telecommunciations Annex provides for a weaker version of the developing countries proposal; it stipulates that parties endorse and encourage the participation, to the fullest extent practicable, of developed and developing countries and their public telecommmunications service providers and other entities in the development programmes of international and regional organizations, including the ITU, UNDP and the World Bank. This provision could be strengthened further to meet the needs of developi ng countries with respect to the establishment of efficient and advanced telecommunications infrastructure.

Developing countries assert the right to cross-subsidize public telecommunications services from revenue derived from telecommunications services operators and users and may impose obligations on foreign suppliers of telecommunications services with respect to transfer of technology, training, provision of telecommunications equipment on concessional terms, location of data resources and data-processing facilities, and access to information and distribution channels. These conditions are included in the Telecommunications Annex.

The developed countries have proposed that pricing be strictly cost-related. This idea appears in the Telecommunications Annex. In view of the public utility responsibilities of public telecommunications organizations in many developing countries, such as the objective of universal telephone service, the presentation of the ability to cross-subsidize would seem essential. Any solution proposed should take into account the full range of responsibilities of public telecommunications organizations rather than simple cost-related issues.

Technical standards have been extensively discussed at the working group and the necessity to promote international standards which are primarily established in the ITU to ensure global end-to-end compatibility and interoperability of telecommunications services were found essential. Standards also are recognized as important to ensure the safety, integrity and interconnection of telecommunications systems and equipment. Whether technical standards should be compulsory is an unsettled matter. For many developing countries, a single, universal

standard for public services and inter-connection of value-added services and leased lines are considered to be necessary. This is because a multiplicity of private, proprietary, equipment standards could entail costly redesign of public facilities. The Telecommunications Annex of the Brussels text contains a recognition of the importance of international standards for global compatibility and inter-operability of telecommunication networks and services and an undertaking to promote such standards through the work of relevant international bodies, including the International Telecommunication Union and the International Organization for Standardization.

B. Transport

In the transport sectors, the inclusion of air and maritime transport in the future framework agreement was questioned by a number of developed and developing countries which considered that the application of some of the principles would have important repercussions in the transport sector and that the present international agreements which regulated trade in these sectors made such application difficult.[42] The issues that were raised with respect to the transport sector included: importance of national security, sovereignty, and environmental and safety considerations, distinction between cabotage and international trade, harmonization of standards and regulations, access to cargoes and passengers, government procurement, subsidies, investment and immigration policies, and the need for internal assessment to examine the readiness for dismantlement of the existing bilateral and multilateral agreements. The developing countries expressed the opinion that the elimination of regulations and bilateral agreements would cause considerable difficulties for them.[43]

42 For example, the application of the MFN/non-discrimination principle fits ill with the bilateral agreements and reciprocity under the Chicago Convention on Civil Aviation and cargo sharing arrangements in the Liner Code, and cabotage is not consistent with market access, national treatment and MFN/non-discrimination principles.

43 See Findlay and Forsyth "ASEAN Interests in Air Transport Services in the Uruguay Round" in *Services in Asia and the Pacific, Volume II*. UNCTAD/ITP/51, Geneva 1990; also P. Faust, "Shipping Services" in *Trade in Services, Sectoral Issues*, UNCTAD/ITP/26, *op. cit.*.

In the civil aviation sector, the developing countries mentioned the need for a fair access to CRSs and congested airport facilities In the opinion of the developed countries, the possible areas for further liberalization were non-scheduled flight services, and ancillary services.

In discussing maritime transport, the issue of coverage and MFN was of particular importance. With respect to coverage, the question was whether all tradeable services (international and cabotage-related services) including ancilliary services were included or whether cabotage should be excluded. Both the United States and the EC shipping industries, for different reasons, want this subsector to be excluded. The EC has asked for derogations from the MFN principle for the bilateral cargo-sharing agreements it has concluded under the United Nations Liner Code, to permit time for the changing of national legislation. It wants this derogation to be extended to any future agreements it may make under the Code. The United States, on the other hand, which does not subscribe to the Liner Code, considers that agreeing to the EC demand would amount to providing protection for EC cargo-sharing arrangements while United States bilateral agreements would be invalidated. A crucial objective for the United States is to maintain the provision in the Merchant Marine Act that allows its administration to retaliate unilaterally against countries regarded as harming United States shipping interests. The developing countries supported the maintaining of existing agreements in this sector, in particular the United Nations Code of Conduct on Liner Conferences[44] which should be viewed as an attempt to address an imbalance in the world shipping markets deriving from certain anti-competitive practices by market operators. They also believed that special attention should be given to labour-intensive ship-building and ship-repairing industries and labour movement (both skilled and unskilled) in shipping such as crews.

In discussing land transport, the EC has also expressed that the MFN and non-discrimination principle should not apply to traffic on inland waterways and to cross-border road transport. Concerning road transport, an important issue was the environmental hazards for transit

44 In terms of the tonnage of world trade, liner cargo accounts for ten to fifteen per cent of the total tonnage. Nearly ten per cent of the liner cargo total is in turn governed by the Liner Code, implying a share smaller that one percent of total world shipping trade for cargoes affected by the provisions of the Code.

states such as Austria and Switzerland and existing agreements on transit. The United States, whose domestic legislation links inland waterways with cabotage or coastal shipping, insists that waterways be handled in the shipping sector and not as part of land transport. Owing to this objection by the United States there is a separate annex on inland waterway transport services was established.

At the Brussels meeting, the Ministers had before them annexes on maritime transport, inland waterway transport, road transport and air transport. These annexes contain derogations to the MFN clause, and the air transport annex excludes the application of the framework to traffic rights and directly related activities which would limit or affect the ability of parties to negotiate, to grant or to receive traffic rights, or which would have the effect of limiting their exercise.

Of particular interest are the maritime and air transport annexes. The Maritime Transport Annex applies to maritime shipping services including associated ancillary services. The annex contains two options on MFN treatment. The first option excludes the application of the MFN to the Annex. The second option provides a more limited derogation from the MFN covering cargo-sharing and reservation measures to the maritime shipping services under existing or future (in brackets) bilateral agreement and arrangements subject to a phasing out requirement. The type of agreements mentioned for phasing out are bilateral agreements and arrangements negotiated in conformity with the provisions of the United Nations Code of Conduct for Liner Conferences and Resolution 2 on non-conference lines and other agreements. There is also an undertaking not to institute new or more restrictive regulations or extend the scope of such regulations to cover non-conference maritime transport such as bulk shipping. At the insistance of some developed countries (i.e. Japan, the United States, Canada) the Annex also contains a derogation from MFN for cabotage covered by specific measures or agreements to be listed in the Appendix of the Annex. The Annex provides for introduction or application of legislation aimed at combating unfair pricing practices in maritime transport, pending the conclusion of negotiations on appropriate disciplines on subsidies and the implementation of their results. Paragraph 6 of the Annex provides that specific commitments on national treatment and market access should not be nullified or impaired through the

introduction of unreasonable or discriminatory restrictions on access or use of infrastructure facilities and auxiliary services such as ports, terminals, berths, storage, handling and other port facilities, whether public or private. The Annex also provides for its periodic review in accordance with Article XIX:1 on application of the framework.

The Air Transport Services Annex applies to all transport by air of passengers, cargo or mail, whether scheduled or not, and ancillary services. Traffic rights and related activities which would limit or affect the ability of parties to negotiate traffic rights are excluded from the coverage of the annex and transparency requirements with respect to these activities would be limited to full compliance with the transparency provisions of the Chicago Convention. Given the existing agreements on air transport, the participants in the negotiations have decided to progressively liberalize this sector through the conclusion of an agreed list of activities which would be reviewed periodically. The list included in the Annex provides for aircraft repair and maintenance, computer reservation systems, selling and marketing of air transport services, and ground handling services.

The Annexes for the various transport sectors make plain that in developed countries the services providers in the various transport sub-sectors seek to continue to operate under existing regimes (including existing sector-specific international agreements), to retain existing protection, and that domestic traffic is not likely to be opened to foreign carriers. In fact, very little of the new multilateral disciplines will apply in these sub sectors - and most of what can be agreed (e.g. non- discrimination in harbour and airport facilities and charges) is, in fact, properly covered already in bilateral and sectorial agreements. The absence of MFN and national treatment for foreign service providers, gives rise to questions as to the relevance of the proposed framework agreement, however, it could provide a basis for future negotiations should technical and political factors (e.g. Europe 1992) lead to a re-negotiation of the existing structure. It is hard, too, to believe that anti-competitive practices in the transport sector will be dealt with any more effectively than it is at present.

C. Tourism

The discussions on the tourism sector were less focused than the other sectors. Tourism is the one service indicated in the balance-of-payments accounts, where a large number of the developing countries show a surplus, and for many, particularly small and island developing countries, constitutes the most important source of export earnings, far in excess of any other good or service. However, developing countries, particularly Mexico, stressed that in actual fact it was the developed countries which possessed a comparative advantage in this sector. The issues which were highlighted during the discussions were the promotion of trade in tourism, domination of world markets by TNCs, anti-competitive activities, visa restrictions, the key role of CRSs, transborder movement of labour, limitation on foreign exchange, taxation and fiscal matters, access to local financial markets, pricing policy, distribution, publicity, and balance-of-payments considerations. The developing countries saw their objectives in the negotiations, not so much as to devise means for obtaining a greater flow of tourists to their countries, than to acquire a more important share of the value-added generated. The tourism sector is where the concept of access to information networks, recognized at the Uruguay Round Mid-Term Review as a component of achieving effective access to world markets for developing countries, is crucial. Access to computerized reservation systems and other information networks is essential for the very survival of firms in this sector, moreover, this situation lends itself to resort to anti-competitive practices by private firms, pointing to a need to strengthen further the provisions on the behaviour of private operators in the framework.[45] The discussion of the scope of the tourism sector was influenced by the concern of developing countries that offers of concessions with respect to the tourism services should not extend to other areas such as financial services and transportation. The Brussels text contains no sectoral annex on tourism.

45 See Françoise Carner, "America Latina y el Caribe: El Comercio de Servicios en Turismo y Las Negociaciones de la Ronda Uruguay", CEPAL, LC/R.937, 24 October 1990, as well as "International Trade in Tourism in the ASEAN Region" in Services in *Services in Asia and the Pacific: Selected Papers; Volume One*, UNCTAD/ITP/51, *op. cit.*

D. Financial services

This question of how to incorporate this sector into the multilateral framework has clearly been a difficult issue in the GNS negotiations.[46] The discussions on financial services covered banking and securities-related services and insurance services, and highlighted the crucial role the financial services sector played in the macro-economic policies of countries. The United States, the EC, Malaysia (on behalf of the South East Asia Central Banks and Monetary Authorities (SEACEN) countries of Indonesia, Malaysia, Thailand, Nepal, Sri Lanka, Republic of Korea, the Philippines, Singapore and Myanmar) and Canada, Japan, Sweden, and Switzerland (joint proposal)[47] have submitted texts to the Working Group. The objectives of both the United States and the EC texts are to remove restrictions on market access for foreign suppliers of banking services. The removal would apply both to cross-border transactions and to the establishment by foreign banks of a commercial presence in a country for the purpose of supplying banking services. Both proposals link market access very closely to national treatment. Under both proposals there would be freedom for international payments and transfers for current and capital transactions associated with the provision of banking services. The proposed mechanism for the achievement of progressive liberalization is the negative-list approach, with temporary reservations which should be removed gradually. The thrust of the proposals of both the United States and the EC is to limit any new measures after the framework's entry into force.

It should be pointed out that such a binding of important parts of countries' systems of banking regulation is likely to have implications that diverge significantly for different groups of countries, in particular for developing countries which have rudimentary regulatory systems. The proposals of the United States and, to some extent, of the EC

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46 See A. J. Cornford, "The Multilateral Negotiations on Banking Services: Context and Selected Issues", UNCTAD Discussion Papers, No. 39, April 1991, as well as Un Hoe Park "Trade in Insurance in Korea" and Mario Lamberte "Trade in Banking Services: ASEAN Countries" in *Services in Asia and the Pacific: Selected Papers Volume I.* UNCTAD/ITP/51, Geneva, 1990.

47 See documents MTN.TNC/W/50 and MTN.TNC/W/52.

could form a separate special agreement, which would exclude this sector from the coverage of the framework and would be applicable only for its signatories.

The SEACEN position, on the other hand, provides that financial services should be included in the coverage of the framework and that the sectoral annotation on financial services should form an integral part of the framework. They believe that the annotations should therefore not impose more onerous liberalization obligations on the financial services sector than in the other services sectors. The text proposed by SEACEN is based on the overriding importance of prudential considerations, monetary policies, and national development objectives. It emphasizes that the liberalization of financial services in the developing countries should be gradual and progressive, taking fully into account the level of development of their financial sectors vis-à-vis those of the developed countries. In their opinion, market access should not imply automatic national treatment, given the different levels of efficiency and expertise between foreign and local financial institutions. Nor should it imply automatic right of establishment or commercial presence. Flexibility, therefore, in the national treatment rule is necessary to reduce such inequalities, and the negotiation of commitments should be based on a positive-list approach.

Developing countries have drawn attention to the following: (i) the strategic importance of this sector in mobilizing financial resources for development; (ii) their concerns with respect to capital flight; (iii) the importance of clear distinction between investment and trade in the financial sector; and (iv) the need for special standards and strict prudential regulations, given the difference between the competitiveness of developed and developing countries in the financial sector.

Due to these disagreements, the Brussels text did not include an annex on financial services. However, during the Ministerial Meeting itself, Canada, Japan, Sweden and Switzerland submitted an annex on financial services (which was virtually identical to the Chairman's text) to serve as a basis for discussions at the Ministerial Meeting. The proposed sectoral annex is a self-contained financial services agreement which would exclude the sector from the overall agreement on services and would involve an instant accord to a programme for the liberali-

zation of financial services and a standstill on existing regulations. The annex, moreover, was designed so as to ensure that concessions in financial services could not be traded for concessions in other service sectors and that there would be no cross-retaliation against financial services - neither within the services agreement and across sectors nor between goods and services. To a large extent it may reflect the concern of government authorities responsible for financial services (eg. Finance Ministries, Central Banks, Treasury Departments) to preserve their autonomy from Trade Ministries and not to have their interests sacrified to obtain concessions in other sectors. This proposal was immediately countered by a proposal by SEACEN which largely reiterated their position described above.

Some observers have argued that, given the current process of transformation of the regulatory structures in the major countries, the most practicable course would be to postpone detailed negotiations in this sector until the EC 1992 programme for this sector (or set of sectors) is fully enacted and operative, and until the reform of the banking industry now being proposed in the United States has been legislated.[48] Many of the issues in this sector, as between the United States and the EC, and as between both of them and Japan, will look quite different once these two events have taken place. If the United States changes its rules on inter-state banking, and on the roles of banks, the negotiating considerations, particularly as regards "reciprocity" as between developed countries, will be different. However, developing countries, and indeed other countries, should not be precluded from offering commitments in this sector, in their initial offers, following the agreed positive list approach, subject to the unconditional MFN clause.

In such an approach, it would be more practicable to separate insurance services from banking and other insurance services, as was found necessary in the Canada/United States FTA.[49] Insurance is a set of sub-sectors for which negotiating considerations differ as from one insurance activity to another. Developing countries may consider that for "reinsurance", for example, which typically involves large risks, their

48 See Rodney de C. Grey, " '1992', Financial Services and the Uruguay Round", UNCTAD Discussion Paper No.35.

49 See Grey op.cit.

interests might be best protected by according market access to the few reinsurers for large risks that are based in developed countries. For mass risks, such as life insurance, they may consider it necessary to impose prudential and other rules in regard to foreign-controlled entities. Transport insurance is another special case. Developing countries, in according access under any appropriate mode, to developed country insurers, could make it a condition that the insurance of goods to and from developing countries is offered on terms not less disadvantageous than to shipments for developed countries.

E. Labour mobility

Labour like telecommunications has a dual role as a service sector and as a "mode of "supply for many other services; like capital it is also a factor of production. It has been apparent from the beginning of the services negotiations that there were a series of sensitive issues regarding the movement across frontiers of the various categories of persons involved in services activities. The main thrust has been to differentiate the "temporary movement of service providers" from "immigration". There are perhaps three categories of such service provider (a) those professions, e.g. lawyers, architects, doctors, all of which require formal qualifications and for which, in virtually all countries, there are licensing requirements, rarely providing for the recognition of qualifications acquired in other jurisdictions; (b) those where no certification is required, e.g. software experts, and (c) the category one might call "contract labour", such as construction crews who enter the country for the completion of major infrastructure projects. The Canada-United States FTA addressed the issue of the temporary movement of business persons and made clear that for professionals, such as architects, the issue is primarily one of the mutual recognition of qualifications.[50]

The interests of developing countries cover a wide spectrum of skill levels and service sectors ranging from exporters of construction and other contract labour, either as part of a package executed by na-

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50 See P. Burn "Professional Services in the US/Canada FTA", UNCTAD/ITP/26, *op. cit.*, as well as Pang Eng Fong and Linda Low, "Labour Mobility, Trade in Services and the Uruguay Round: The Perspectives of ASEAN countries", UNCTAD/ITP/51, *op.cit.*

tional firms or as a supplier of labour to foreign firms, to skilled medical and maintenance personnel and highly qualified professionals including those requiring certification, as well as others who do not (e.g. software experts). It is apparent that for many countries there are many restrictions on the movement of professionals, and that this complicated issue needs considerably more study, especially if developing countries are to be able to formulate specific requests.

Of particular interest is the Annex[51] on "Temporary Movement of Services Personnel" proposed by Argentina, Colombia, Cuba, Egypt, India, Mexico, Pakistan and Peru, which was intended to set out in the form of concrete obligations the principles relative to movement of personnel as a mode of delivery as agreed in paragraphs 4 and 7(e) of the results of the Mid-Term Review. Nothing in the Annex was intended to affect immigration laws and regulations dealing with permanent residence, establishment or citizenship. It was envisaged that in the negotiation of specific access commitments, parties to the framework could agree to apply this Annex to those sectors or sub-sectors for which they would grant market access, with respect to the cross-border movement of services suppliers, as provided in their schedules of concessions. In particular, the Annex endeavoured to ensure that immigration regulations neither act as an unnecessary barrier to trade in services, nor nullify and impair benefits expected under the future framework. The Annex also provided that the developed countries parties to the framework in providing effective access to their markets should liberalize their national regimes so as to enable not only developing-country firms supplying services abroad to recruit personnel from their own domestic sources, but also all service firms to recruit personnel from the source which is economically the most advantageous, with respect to sectors where concessions have been made. The parties should also ensure that arrangements for the extension of recognition of professional and technical qualifications were not frustrated by the application of immigration laws. Mexico further explained that the Annex covered the temporary movement of all categories of service personnel essential to the effective delivery of a service. Such movement should take place under conditions of specificity of purpose, discreteness of transactions, and limited duration so as to facilitate the provision of

51 MTN.GNS/W/106

services through time-limited contracts. Temporary movement of personnel could take place through corporate structures, hiring entities, and individual movement of qualified professionals and tradesmen. The Annex also elaborated on the framework concepts of transparency, non-discrimination and national treatment.

The major definitional problem with respect to this mode of delivery concerns the meaning of "essential", when applied to service providers. Whereas in the opinion of the developing countries this term should cover all categories of service personnel, developed countries believe that it only covers managers, specialists and executives. Another related question is how to distinguish between temporary movement of labour necessary for the production of services on the one hand, and immigration issues on the other - especially when movement of individuals takes place outside corporate structures.

Recently, an attempt has been made to reopen this issue in proposals which envisage that the movement of natural persons would be dealt with through (i) an across the board minimum commitment on movement of service sellers and intra-corporate transferees (managers, executives, and specialists), and (ii) the possibility of negotiations of additional specific access provisions for natural persons in the context of specific sectors. This reflects the earlier stated positions of developed countries that labour mobility is a horizontal sectoral issue, that movement should be limited to essential personnel (i.e. highly skilled and managerial), and that sectoral specificities should be identified in different sectoral agreements which would specify the essential service providers. Those following this approach have stressed that work should concentrate on who would be provided entry and on the treatment of personnel subsequent to entry. Such an annex would, therefore, only provide for entry of a specific and limited list of categories linked to intra-corporate transfers and thus subordinate to concessions with respect to the presence of juridical persons.

These proposals would seem to undermine attempts to establish a degree of symmetry between the movement of labour and capital by sub-ordinating the former to the latter, and would seem to put into question the possibility that concessions with respect to movement of all categories of personnel mode of supply could be negotiated on a

sectoral level except in exceptional cases. Since, according to these proposals the developing countries would be obliged to provide automatic access with respect to the personnel of interest to developed countries to render their commercial presence effective, yet they would be obliged to enter into additional negotiations to obtain access for other categories of personnel.

The annex included in the Brussels text is influenced by the proposals put forward by the developing countries. It provides for temporary movement of "natural persons" performing particular services, in respect of which access commitments have been undertaken and specifies that it does not apply to individual job seekers, and does not affect national laws and regulations regarding citizenship, or immigration related to residence or employment on a permanent basis.

The Labour Mobility Annex would set out in the form of concrete obligations a minimum commitment relative to temporary movement of all categories of personnel as a mode of supply, which would be applied to those sectors and sub-sectors for which concessions with respect to "natural persons" mode of supply have been included in the Schedules of concessions; there is

need to elaborate upon the Annex to:

(i) include a transparency obligation in the Annex in order to provide information on the procedure and regulations concerning the granting of entry for temporary stay (analogous to that proposed in the Telecommunications Annex;

(ii) draw up a comprehensive "illustrative list of natural persons performing particular services covering broad categories of sectors and skill levels". This list would provide an agreed categorization and terminology to be included in the Schedules;

(iii) clarify that firms may recruit from the source which is economically most advantageous, in sectors and for categories where bindings have been made in this mode;

(iv) clarify that "natural persons" cover the temporary movement of individual self-employed service provider, regardless of whether they are affiliated with corporations;

(v) Schedule arrangements on mutual recognition and harmonization of professional qualifications, and the relationship between agreements under Article VII of the Brussels text and commitments on national treatment at the sectoral level in the Schedules.

F. Professional services

The professional services sector was considered in a broad horizontal approach, including both "accredited and non-accredited services".[52] Most countries highlighted the importance of mutual recognition of qualifications, harmonization of qualifications, conditions of licensing, role of professional bodies, visa requirements, work permits, foreign-exchange restrictions, distortive subsidies, and heterogeneity of this sector. It was pointed out that access to some professional (or "business") services was not regulated (e.g. software and audiovisual services) whilst other professional services were highly regulated and required licensing (e.g. medical and legal professions). It was noted that regulating the professional services sector has often been delegated to professional bodies and associations. Many countries referred to the need to develop guidelines for mutual recognition of qualifications. The importance of consumer protection, foreign-exchange management, and protection of cultural and national policy objectives was also highlighted.

Many special characteristics of interest in the professional services were highlighted in the Group: (i) the professional services consisted of a wide range of heterogeneous services; (ii) some professional services were licensed or accredited by governments or by private professional bodies to maintain standards; (iii) there were differences in the scope

52 See T. Noyelle "Business Services and the Uruguay Round" in UNCTAD ITP/26 *op. cit.* and "Computer Software and Computer Services in Five Asian countries" and Seih Lee Mei Ling "Professional Business Services in ASEAN and the Uruguay Round Trade Negotiations in *Services in Asia and the Pacific: Selected Papers Volume One*, UNCTAD/ITP/51 Geneva 1990.

of professions in different countries and there were differences between countries in requiring accreditation/licensing in a given profession; (iv) some professional services could be delivered across the border by telecommunications, whereas others required temporary presence and yet others required establishment of firms; (v) some professional services are performed by individuals acting on their own account, and others were delivered by firms or groups of professionals; (vi) regulations were developed by governments at national or subnational level or by professional bodies; (vii) barriers exist in both accredited and non-accredited services including denial or selective issuance of visas and work permits, regulatory impediments to commercial presence, subsidies problems of access to services, and maintenance of recognition of qualifications; (viii) the question of the role of mutual recognition agreements and their relationship to the framework; and (ix) the possible applicability of "formula" approach to this sector, in particular to the non-accredited professional services. There is a need to examine whether and how the framework would result in liberalization of certain aspects of professional services, for example in the cases of non-accreditation, non-recognition of foreign qualifications, non-recognition of non-citizens or non-residents, restriction of staff that could be employed, prohibition of using firms' names, denial of access to transborder data flows or telecommunication services, and denial of taking examinations for completion of qualifications.

Most countries, except the United States which proposed two annexes for accountants and lawyers, believed that an annex would not be needed in this sector as long as the question of mutual recognition and harmonization could be adequately tackled in the framework. The Brussels text does not include an annex on professional services sector but contains an Article VII on "Harmonization and Recognition" in Part II of the framework text.

In the professional services sector, the focus will therefore be on the question of mutual recognition of qualifications agreements, and on developing objective criteria for establishing minimum standards or harmonization of standards. It will also focus on the need for special attention to transparency requirements both as regards the requirements of countries and how these were to be met, and on harmonization or recognition of qualifications and domestic regulations. Expanded

transparency commitments are needed in this sector, given the requirements for prior approval of professional qualifications and licensing, notification of appropriate regulatory bodies, and examination procedures to facilitate work on harmonization and mutual recognition. Developing countries are specially concerned with the mobility aspect of professional services which was addressed in their proposed annex discussed above.

Regarding MFN, the United States questioned whether unconditional mfn could be applied in the absence of internationally accepted minimum standards or mutual recognition of qualifications. Such a situation necessitated the formation of bilateral agreements. The EC, on the other hand, supported the full and unconditional application of MFN from the outset of the agreement and pointed out that the related issues of standards, technical qualifications and mutual recognition should not necessarily be seen as an MFN question, but rather as an aspect of domestic regulation and therefore the issue of bilateral agreements should be discussed further. Most participants found MFN applicable, although referring to the need to deal with bilateral agreements and economic integration agreements.

The importance of the positive-list approach was stressed by developing countries. Such different modalities for negotiating market access were discussed as bilateral request/offer negotiations, and a formula approach, wherein certain kinds of activities would be liberalized by all participants in a uniform way and to a uniform extent. The United States proposed to draw up a list of professionals to whom entry could be granted immediately through simplified immigration rules, recognizing that entry alone did not give the right to practice. It was also pointed out that the non-accredited professional services could be candidates for early liberalization by the formula approach.

G. Audio-visual sector

The negotiations in this area are influenced by four main considerations: (a) the extremely dominant position of the United States in trade in cinema and television programmes, and the dependance of the United States film and television industry on export markets; (b) the widespread practice of most countries to restrict presentation of im-

ported programmes for motives relating to the preservation of cultural values; (c) technical advances such as satellite TV broadcasting, high-definition television and expanded cable TV networks, particularly in Europe; and (d) "Europe 1992" and the "Television without Frontiers" initiative, which should result in broadcasting preferences in favour of EC material in all EC member states.[53]

In the Audio-Visual Services Group which did not hold its first meeting until August 1990, much of the discussions focused on the issue of preservation of cultural values. Whereas the United States strongly opposed any exception that would permit cultural values to be used to justify a lower level of concessions in audio-visual services (or other sectors), whether as a general exception in the overall framework or in any sectoral annotation, other countries recognized that the cultural issue was of crucial importance in this sector and would have to be taken into account in negotiating trade in audio-visual services, but they had different views on how to deal with the issue in the general framework. Some, particularly the EC and the Nordic countries, were in favour of recognizing a particular sectoral annotation which would provide for liberalization in this sector while recognizing the legitimacy of policy instruments aimed at preserving cultural values. Australia recognized the legitimacy of cultural protection, but considered that this could be covered by omissions from the schedules and not require a separate sectoral annotation. Others, such as Canada, Hungary and India, considered that cultural aspects extended beyond the audio-visual sector and should be dealt with through a general cultural exception to the framework itself. The public nature of this sector, its close link with telecommunications sector, and its coverage including production, distribution and diffusion were also discussed. With respect to the application of principles and concepts, potential problems were highlighted in the application of MFN, market access, and national treatment because of existing co-production and other relevant bilateral agreements. With respect to market access, temporary movement of personnel, access to distribution channels and restriction on foreign ownership were

53 For discussion of the main issues in this sector see Christopherson and Ball "Media Services: Consideration Relevant to Multilateral Trade Negotiations" in *Trade in Services: Sectoral Issues*", UNCTAD/ITP/26 Geneva 1989 and Malati Tambay Vaidya "Trade in Media Services: Asia and the Pacific Region" in UNCTAD/ITP/51 *op cit*.

also considered pertinent issues. On increasing participation of developing countries, the issues of transfer of technology, training of personnel and access to distribution channels and information networks were of particular concern for developing countries.

The Brussels text contains an Annex on Audiovisual, Broadcasting, Sound Recording and Publishing Services which provides for some derogation to the MFN principle covering any activities in the audiovisual sector that are undertaken in pursuance of cultural policy objectives. Article XIV on "Exceptions" also includes a square-bracketed provision on cultural values which could meet the concerns of countries which would not wish to liberalize this sector for cultural considerations, and permit them to enter into special arrangements with countries with which they share cultural affinities. In this context, it should be noted that developing countries in various regions, particularly in Latin America and Africa have developed arrangements aimed at expanding production and their mutual trade as well as defending their cultural heritage.

V. INITIAL COMMITMENTS

A. Submission of offers

The United States, EC, Switzerland and some other developed countries have been strongly pressing for initial commitments from all countries as an integral part of any multilateral framework and a condition for its acceptance. The United States has made its acceptance of the incorporation of most-favoured-nation clause in the multilateral framework conditional upon initial commitments being made by a sufficient numbers of countries with respect to sectors of export interest to the United States. Developing countries have endeavoured to postpone the negotiation of initial commitments because they believe that it is not possible to negotiate these commitments in a situation where the rules of the game are not yet clear. As the framework and the annexes/annotations have not yet been finalized, there are crucial unresolved issues such as application of MFN, definition, coverage, safeguards, dispute settlement, non-application, derogations and exclusions. Some developed countries have stressed that only those countries which

have made initial commitments would be able to sign the agreement upon its entry into force, and others will have to accede paying a higher price as an entry condition. Moreover, some developed countries are supporting a general non-application provision which would exclude countries from the benefits of the framework, not only when they have not entered into direct negotiations as in GATT Article XXXV, but also if the commitments are not found to be sufficient.

By 22 June 1991, twenty four conditional offers concerning initial commitments on the basis of a set of explicit or implicit assumptions have been submitted by the following: Australia, Austria, Brazil Canada, Chile, Colombia, Czech and Slovak Federal Republic, EC, Finland, Hong Kong, Iceland, Indonesia, Japan, Republic of Korea, Mexico, New Zealand, Norway, Poland, Romania, Singapore, Sweden, Switzerland, Turkey, and the United States. The offers submitted by the developed countries are notably timid in their inclusion of movement of personnel as a mode of delivery. The United States offer does provide for movement of essential personnel (managers, specialists, etc.). While Canada makes a comparable commitment, the EC leaves this mode of delivery for further consideration. The other offers indicate that this mode of delivery is "unbound". These offers, in their present stage thus do not provide for symmetrical treatment of the movement of factors of production.

It must be recognized, however, that these submissions constitute initial offers which will presumably be open to improvement through the request/offer procedure. This would seem to place considerable importance on how the requests are formulated, and the degree of precision in the request/offer negotiations and the concessions made on this mode, including how to obtain sufficient imformation to ensure that requests can be appropriately formulated and that the implications of offers of bindings can be effectively assessed.

All offers are conditional, which means that at the time of the closure of the negotiations on the framework countries will evaluate the result of the negotiations on the basis of certain criteria. Some of the criteria mentioned in the initial commitments include:

- Quality and number of offers by other parties;

- Content of the framework, sectoral annexes, and the extent of the link between the framework and the GATT;

- Universal coverage of the framework which should be demonstrated by the list of concessions or sectoral annotations;

- Inclusion of unconditional MFN clause;

- Binding of all regulatory bodies, whether national or sub-national, governmental or non-governmental; and

- Firm commitment that parties may not take any measure which would improve their negotiating positions.

The fact that the negotiations on the framework have not been completed has compelled countries to include detailed conditions and explanations as part of their offer.

B. Nature of offers

The offers that have been submitted so far differ substantially in their presentation, in the type of measure included, in the method of reference to specific types of measures and in the degree of detail. Whereas the United States and the EC offers are very detailed, the Polish, Chilean and the Canadian offers are very brief and refer to a general standstill. The Mexican offer spells out in detail the meanings of the various expressions used and provides head notes on existing legislation. The type of existing legislation offers refer to as generally applicable limitations, conditions and qualifications include relevant legislation and policies applicable to foreign investment, national immigration regulations and procedures, competition laws, taxation, land acquisition, and prudential and professional competency requirements and transfer of technology policies. At this stage of the negotiations, there is a need for a common approach to formulation of schedules in order to ensure that the contractual elements represented by each party's schedule is as unambiguous as possible, so as to achieve specificity and clarity of commitments.

Article XVIII of the draft framework provides that for each round of negotiations aimed at achieving the progressive liberalization

of trade in services, negotiating guidelines and procedures should be established. The Brussels text also contains a note, laden with brackets, intended to set out guidelines for negotiations of the initial commitments, providing that such commitments have regard to the level of development of each participant and the situation of countries in economic transition, with a view to achieving a balance of interests. The type of commitments mentioned are: (i) commitments to bind the existing levels of market access and/or new market access undertakings, by specifically indicating limitations and conditions on market access in its different forms prescribed in the agreement and/or by positively indicating the specific liberalization undertakings; (ii) commitments to bind existing conditions and qualifications on national treatment, and/or to bind the total or partial elimination of such conditions and qualifications; and (iii) any additional measures to achieve market access. The note provides for the following guidelines: (i) negotiations should take place on the basis of an indicative list of sectors as well as an illustrative list of physical persons; (ii) in order to provide appropriate flexibility to individual participants, in particular to individual developing countries, and in line with their development situation, commitments shall be established at the appropriate level of disaggregation, in relation to categories of sectors, sub-sectors or transactions; (iii) the extent of each party's commitment shall take into account the general level of liberalization already achieved internationally in the services sector concerned and its share in international trade in services, as well as the level of development and the degree of liberalization of party in that sector, the need for appropriate flexibility through binding at more restrictive level than the existing situation - particularly in relation to the individual level of development of the party- and the need for negotiation on sectors and modes of delivery of priority interest to developing countries; and (iv) appropriate flexibility should be negotiated for parties, in particular for developing countries, to phase in on the basis of agreed time-frames the implementation of negotiated commitments.

The initial commitments so far submitted clearly indicate that these guidelines, which are of course not yet agreed upon, have not provided sufficient guidance for countries in the presentation of their initial commitment, in particular on the types of measures to be included, on an agreed nomenclature (as mentioned above the reference

list of the Secretariat has been found too vague), clear delineation of modes of delivery, definition of sectors, criteria for clear distinction between market access and national treatment, and use of vague and unprecise terminology ("no limitation", "standstill", "unbound", "bound", "no restriction", "not applicable").

Some schedules have gone as far as to provide a description of the present regulatory situation since they recognize that they are submitting these initial commitments in a situation where there is no agreed framework agreement or sectoral annexes. Moreover, even the provision included in the Brussels draft agreement on the recognition of the right of parties to regulate the provision of services within their territories in order to meet national policy objectives is bracketed. The provision that the developed countries prefer to retain is that such regulations should be based upon objective criteria, such as competence and the ability to provide services, and not be more burdensome than necessary to achieve national policy objectives. The interpretative note on this provision, moreover, stipulates that requirements which are not based upon objective criteria shall be considered as restrictions on market access and/or limitations on national treatment, and when a specific commitment is made, it should be inscribed as appropriate, in the party's schedule. The agreement does not clarify what these objective criteria are. How should a distinction be made between regulation that needs to be scheduled and objective regulations which do not require to be scheduled? This question is also related to the types of measures that could be scheduled which could include: residence requirements, monopolies, qualification requirements, nationality requirements, non-discriminatory measures which limit access to operations in the market, prudential measures, measures based on administrative discretion, etc. Should the parties include any measure that interferes with market access and national treatment in specific sectors and sub-sectors imposed by national, sub-national, governmental or non-governmental body?

Some suggestions have recently been put forward as to possible criteria for the evaluation of offers, e.g. by linking coverage of offers to total national production of services. This approach tends to distract from the central issue, that is that (a) developed countries are the "demandeurs" in the services negotiations, (b) developed country cor-

porations possess the means to deliver services, and are thus able to profit from liberalization while developing countries are not. In other words, offers can only be "evaluated" in the light of requests, if developing countries are to accord market access and national treatment in sectors dominated by the corporations of a few developed countries, they should be provided with effective access for their services (including movement of labour) on a reciprocal basis.

C. Frontier between market access and national treatment

An examination of the initial commitments that have been submitted also demonstrates that there is a confusion between which commitments should be specified as relating to market access and what should be included under national treatment. There is a need to formulate some common understanding on the distinction to be made between limitations on market access and qualifications on national treatment. Many offers include existing legislation as general limitations, qualifications and conditions applicable across all sectors. Such legislation include foreign investment laws, taxation regulations, prudential and professional competency requirements, immigration policies and requirements, laws on formation of legal entities with corporate or non-corporate structure, laws on competition, consumer protection and marketing, foreign exchange control and land acquisition regulations. Some delegations consider that such differentiation is not necessary as any measure which discriminates against foreign suppliers would, in fact, constitute impediments to market access and deviations from national treatment. Such an approach would imply, however, that only those sectors or sub-sectors where both national treatment and market access were granted could be included in the schedules. It also overlooks the possibility that countries might decide, in particular sectors, to grant concessions with respect to national treatment but not on market access (i.e. the situation in the OECD).[54] This approach also indicates a preoccupation with the "commercial presence" mode. The difference between national treatment and market access is somewhat clearer in the case of movement of persons. Market access by foreign suppliers of services through the mode of delivery of labour means the right of persons to legally be present in the importing country and to

54 See R. Grey *op cit*

supply their services. The schedule should provide for visa requirements, labour certification requirements and conditions for the licensing of foreign professionals, and the length of stay granted i.e. "short -term entry" or "temporary residence". On national treatment the major restrictions which need to be scheduled in natural persons mode of delivery are limitations on the licensing and other restrictions on the activities of foreign professionals, such as citizenship and residency requirements and recognition of qualifications, wages and social benefits, living conditions and civil rights, and training facilities.

The difference between market access and national treatment should be quite evident to firms and individuals involved in business. One could surmise that they would consider "access" as a legal right to be physically present in the foreign country, while "national treatment" would be the extent to which they were subject to a regulatory regime providing them with a treatment no less favourable than that extended to domestic suppliers.

D. Differentiation between modes of delivery

There is also a blurring of the border between the different modes of delivery in the offers. This has been caused by the difficulties in distinguishing cross-border trade from movement of consumers and personnel, which arises in particular sectors. For example, some have considered the movement of professionals for the delivery of a service as cross-border trade, whilst others have considered it as movement of personnel and some others as commercial presence. Clarification is needed to distinguish at what point the temporary, short-term presence of a person becomes commercial presence. This question of course is related to the definition of trade in services which should be settled in the context of the framework agreement, but it is also desirable that some guidelines are formulated to distinguish clearly between the four modes of delivery in the schedules themselves.

The definition of modes of supply in the framework needs to clearly recognize that all physical movement of persons would fall within the "presence of natural persons" category in that (a) the presence of juridical persons takes place through the estalishment of a legal entity in the importing country", no physical movement of person is

implied or required, and (b) the act of entering a foreign country, even for a few minutes, requires compliance with the same immigration laws and regulations that would have to be addressed with respect to bindings of the "natural persons" mode.

It might facilitate both the conceptual approach to the delineation between modes of supply, as well as the negotiation of specific concessions if, as a "rule of thumb", it could be agreed that concessions with respect to cross border movement would essentially deal with regimes relating to communications and the movement of services in the form of goods (e.g. diskettes, documents), as well as foreign exchange regulations, the movement of consumers would primarily deal with foreign exchange regulations, presence of "juridical persons" with investment laws and foreign exchange laws and presence of natural persons with immigration laws, labour laws and professional qualifications (including those imposed by non-governmental entities).

E. Nomenclature/Terminology

The inadequacy of the reference list formulated by the GATT Secretariat for the purposes of the negotiation of commitments, has become obvious during the initial commitment exercise. Major problems have been caused by the lack of an appropriate nomenclature and definition of sectors in that it is difficult to assess the scope of the sectors and sub-sectors for which commitments are being offered. A greater harmonization of classification of sectors is required to continue the negotiations of initial commitments and to be able to evaluate these commitments and the degree of liberalization of market access contained in the commitments. There would seem to be a need to develop a nomenclature based on the terminologies and descriptions generally used by traders in the services concerned (i.e. practitioners language). Sectoral "headnotes" analogous to those contained in CCCN might constitute the most pragmatic approach.

Another difficulty that has become apparent in the examination of the offers is the terminology used for indicating the conditioning of market access and the qualification on national treatment. Some countries use the terms "no limitation" and "standstill" interchangeably, and it is not clear whether countries are opening up markets or if they are

freezing the existing measures. The Japanese offer, for example, contains definitions of the terms used in its offer. It would be useful to agree on the exact definition of these terms to enable countries to evaluate the obligations undertaken under the offers.

VI. GENERAL COMMENTS

It would appear that work toward a final agreement will focus on: (i) the text of the multilateral framework itself; (ii) the sectoral annexes which have been proposed to deal with maritime, inland waterway, road and air transport services, basic telecommunications services, financial services, labour mobility, and audiovisual, broadcasting, sound recording, and publishing services; and (iii) the negotiation of initial commitments with respect to market access and national treatment. The informal manner in which the Round has been resumed and the informal nature of bilateral and plurilateral talks that are taking place on crucial issues before the negotiators such as initial commitments would mean that, in the final stages of the negotiations, the developing countries would have to exert even greater vigilance to ensure that the negotiations would take place in a transparent manner (the financial services sector negotiations have unfortunately served to demonstrate the tendency that the interests of developing countries are the first to suffer where transparency does not prevail).

The structure which has emerged in the negotiations would seem largely to conform to that envisaged in the joint proposals put forward by developing countries, particularly in the "Afro-Asia" proposal. The most crucial issue is to maintain the positive-list approach to the negotiation of the commitments, as recent proposals by developed countries would seem to indicate that difference of views between the proponents of across-the-board access commitments, subject to reservations (comparable to the approach followed in the OECD), i.e. a negative-list approach; and that of developing countries, which favour a positive list of concessions comparable to article II of GATT still exist. Given the asymmetry in the situation of developed and developing countries, world trade in services being dominated by enterprises from developed countries on the basis of their strength with respect to capital, technology and information, a balanced solution would permit the developing

countries to strengthen their service sectors and to acquire the ability to penetrate world markets for services. It would mean that developing countries would be provided with a structure under which they would receive "credit" for any commitments they might make to liberalize their service sectors, which could be "traded-off" for market access in service sectors where they have competitive possibilities and other advantages such as transfer of technology, resources, etc.

The above-mentioned asymmetry could also be mitigated by matching any provision for free movement of capital to deliver services with that of freer movement of labour for the same purpose. The positive-list approach would imply that developing countries would be required to accept market-access commitments only in return for effective access to the markets of developed countries. Developing countries could not be requested to make future concessions unless they were able to derive meaningful benefit from the framework. Market access in terms of liberalization of regulations will not benefit developing countries unless they are provided with the means of strengthening the competitiveness and efficiency of their service enterprises, and of delivering their services to foreign markets. This requires action with respect to the issues specified in Article IV of the Brussels text, access to technology, and to distribution channels and information networks, as well as effective multilateral action to deal with anti-competitive practices covered by Article IX.

The other crucial questions facing the negotiators are principles of unconditional most-favoured-nation treatment, universal coverage and the right of developing countries to stipulate conditions (e.g. transfer of technology) for foreign firms benefiting from concessions, and ensuring that their concessions be based on both their level of development and the benefits obtained from the concessions of other participants, and on stronger rules dealing with anti-competitive practices.

At the time of the publication of this paper, attention in the negotiations is focused on the conditional offers circulated as initial commitments by over 24 countries. These offers are complicated by the fact that they are being negotiated in the absence of a multilateral framework which, as noted above, has left the MFN treatment of certain sectors in question. The offers demonstrate the willingness of developing countries to make substantial concessions in a wide range of services.

However, there has been reluctance to enter into bindings with respect to the temporary movement of personnel. A series of technical problems remain to be resolved relating to the description of sectors and nomenclature, including that of the different characteristics of the modes of delivery in different sectors. One problem that will have to be confronted is that of ensuring that the offers of the industrialized countries provide "effective access" to their markets for developing country exports of services. The reluctance of the industrialized countries to offer firm commitments with respect to the movement of personnel will somehow have to be overcome if this objective is to be achieved.

The Uruguay Round can be expected to result in a framework for the future negotiation of liberalization commitments in specific service sectors, and hopefully will contain specific obligations to correct the assymetry and effectively address the quasi-private sector issues identified in the preceding paragraph. The conclusion of the Uruguay Round may roughly coincide with the UNCTAD VIII to be held in Cartagena, Colombia in February 1992. This Conference should provide the opportunity to establish a major work programme on services complementary to, and supportive of the expected results of the Uruguay Round. The thrust of this programme would be to devise policy measures aimed at correcting the assymetries mentioned above and to assist developing countries in maximizing the contribution of services to their development process, and in increasing their participation in international trade in services including by effectively taking advantage of concessions negotiated. Such Programme would involve a continuation of the intellectual work being conducted by UNCTAD as well as an extension and intensification of the technical assistance at the national level. In the latter case providing a structure aimed at facilitating mutual support among national study activities.[55]

UNCTAD would also seem to have an important role to play in maintaining an overview of developments in the various service sectors. This could provide the basis for policy recommendations by the

55 Under its technical assistance mandate, UNCTAD has been responsible for the execution of a series of national studies on services in developing countries see, for example, "Mexico, Una Economia de Servicios", UNCTAD ITP 58.

UNCTAD Trade and Development Board with respect to measures which could be taken to strengthen the service sectors in developing countries and increase their participation in world trade in services. There would also be a need for UNCTAD to work more closely with the private sector to assist developing countires in dealing with issues such as access to information networks and distribution channels.

SERVICES, TRADE AND DEVELOPMENT

*Flavia Martinelli**

INTRODUCTION

A major element in the transformations in the services sector over the past decades has been the rise of what has been called "producer services" - i.e. those services that function as inputs into the process of production of goods or of other services. At the microeconomic level, there has been a pronounced tendency towards the externalization of service production by manufacturing firms, resulting in the emergence of producer services as an independent sector. This has enabled firms to attain greater efficiency through specialization, to make savings on research and development (R & D) costs, and to meet peaks in demand without undertaking any permanent expansion of staff or any substantial new investment in capital equipment.[1] Technology has played a crucial role in these changes, as the increase in the use and capacity of computers stimulates the externalization process by facilitating the operation of small, specialized service firms.

The growth of producer services in the contemporary economy has occurred mostly in advanced countries. There is a reason for this. The development of services production has a symbiotic link with progress in the production of goods. It is now widely recognized that producer services are in fact largely the result of the extended technical and social division of labour characteristic of contemporary economic development. Furthermore, producer services are not only a result of developments in industrial production, but they in turn significantly affect the patterns of growth and competitiveness (among firms, sectors,

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1 See UNCTAD, *Services in the World Economy* (United Nations Publication, UNCTAD/TDR/8/Offprint), pp. 144-46.

nations), as they are powerful vectors of innovation and hence of increases in productivity and/or efficiency. Another important aspect to consider is the fact that producer services contribute a growing share of total value added.

The increased division and specialization of labour features a value-added chain in which services, whether upstream, onstream or downstream (see section I A below) begin to prevail over the material production phases. This phenomenon occurs with both "internalized" services (i.e. services provided within the firm) and "free-standing" ones, suggesting, among other things, that the actual share of producer services gross domestic product (GDP) in national accounts is largely under-estimated. It is important to stress that advanced countries, due to their lead in the development of such activities, create and retain within their borders the large majority of world services' value added. A new international division of labour thus emerges, where advanced countries dominate the highest value-added activities (which are also those setting the direction of change and the terms of trade), whereas developing countries are left with the least value-added activities in the primary and secondary sectors and assume "captive" production characteristics.

It must be stressed that producer services are strongly related to trade, and are themselves increasingly traded. Several infrastructural and downstream services are actually a condition for trade in goods and for its enhancement (e.g. transportation, telecommunications, marketing and distribution services). Furthermore, services are also increasingly traded, as developed countries, after having developed services for themselves, try to increase their sales and explore new foreign-market outlets. These considerations explain why producer services are increasingly considered a crucial element in the development process and in the international division of labour, as well as a strategic ground for international trade negotiations.

The sector has rather complicated production-distribution characteristics and its developments are strongly related to other very important contemporary changes. The immaterial nature of most service inputs and outputs (i.e. their high know-how and information content) on the one hand, and their strong transactive character (the service comes into existence the moment it is delivered) on the other, call for

a strong analytical focus on the structure of both the supply of and demand for services, particularly the latter. In essence, the structure of producer-services supply can be understood only by looking at the structure of its market, i.e. the industrial system, and the relationship between these two elements. Precisely because of the sector's production-delivery characteristics, the forms of trade in services are rather more complex than those in goods: service transactions also occur (and perhaps increasingly so) through the movement of factors of production. A fairly large part of international sales of services actually occurs through the establishment of foreign branches or affiliates, i.e. through foreign direct investment (FDI).

Finally, the growth of both services themselves and trade in services is closely linked to developments in new information technology (NIT). As is increasingly recognized, progress in NIT affects to a great extent management and service activities, all of which have a strong information content. These in turn affect patterns of trade in goods. In a time of increasingly complex international transactions, access to NIT is crucial.

These are some of the reasons why the issue of trade in services is strongly related to that of trade in goods, new technology transfer, and FDI. Policy-making, especially in the Uruguay Round negotiations on trade in services, cannot effectively be treated separately from negotiations on these other issues. Industrial development policy (including trade regulation) must still be pursued and in strict connection with policies on services. Furthermore, as services themselves are quite diverse, some attention needs to be given to examining them individually.

In this paper, four key parameters are proposed for assessing the role, the potential performance, and the policy guidelines regarding specific producer services in the developing countries. These parameters serve in the attempt to unravel some of the very complex, interrelated issues involved in the matter of services:

(a) The particular links to production - i.e. the position in the accumulation cycle and the way services interact with their market (upstream, onstream, downstream and "transversal" services) -

which affect the place and mode of delivery and trade, as well as the "strategic" potential of each service in development.

(b) The factor content - i.e. the weight of different factors of production (money capital, fixed capital, human capital, information) - with its different degrees of availability and mobility, influencing the mode of transactions.

(c) The prevailing structure of supply and markets, as they determine monopolistic versus competitive forms of services production-delivery, which influences comparative advantage. Particularly relevant from this point of view is the issue of "internalization", i.e. services provided within the corporate structure of large transnational corporations (TNCs).

The above parameters are proper to services, but in order to assess national development potentials and requirements they must be further examined in terms of:

(d) The degree of development and the size of individual countries.

Only in this way is it possible to investigate: (i) the existing barriers to entry and the possible comparative advantages of developing countries, particularly in the light of developments in NIT; (ii) effective strategies (i.e. whether to buy, when to develop domestically and even export services, and/or sustain FDI); and (iii) a few general regulation guidelines (e.g. protected versus open domestic markets, as well as related basic requirements).

In general, given the complexity of the issue, a very loose multilateral framework is suggested, based on reciprocity and setting a minimum of requirements, which preserve the rights of individual countries to negotiate on a bilateral basis according to their best development strategies.

I. KEY ANALYTICAL PARAMETERS

A. Position in the production/distribution chain

Producer services are by definition intermediate factors, i.e. inputs into the complex cycle of production/distribution of goods and services ranging from the mobilization of resources and the development of products and processes, through the organization and co-ordination of material production, down to the distribution and marketing of final products. A first criterion for classifying services stems thus from their position and role in the complex chain of value-added formation, which also influences their location.

The classification used in a number of studies carried out by UNCTAD is a step in this direction as services are grouped there according to whether they are delivered before, during or after material production. Services such as mobilization of financial resources, research and development (R & D), design and engineering, procurement of factors of production and training, which assure the background conditions of operations, are considered *upstream*. Services such as management and co-ordination of operations (including accounting, legal, and other such professional services, but also inventory control), maintenance, quality control, etc., which ensure the working conditions of operations, are considered *onstream* services; those such as transportation, brokerage, wholesale and retail distribution and advertising, which ensure the actual delivery and sale of products on the final market, are *downstream* services.

Given the peculiar nature of services, consisting as they do of an immaterial labour input at various stages of the production/distribution process, generally requiring a unique transaction and close interaction between the supply and the consumption/embodiment of the service itself, the particular stage where services contribute to the production/distribution process is important because it significantly affects the location of service supply. The latter can thus be considered a function, among other things, of the international division of labour, i.e. the geographical allocation of various segments/stages of the

production/distribution cycle. Upstream services are, in principle, located near management headquarters, onstream services near production operations, downstream services closer to final markets.

However, this simple assùmption, which rests on the hypothesis that there is a need for close interaction between the supplier and user of services, is subject to rather substantial complications. Firstly, advances in new information technology (NIT) are increasingly relaxing the need for close physical proximity between supply and demand of producer services (see section I.B.4 on Information). Secondly, the classification proposed above does not coincide with the traditional "industrial" classification of service activities. Financial or insurance services, for example, are used in all stages of the production/distribution chain; technology consultancy is both an upstream and an onstream service; transportation services are used in the procurement of intermediate inputs as well as in final distribution.

Many producer services can, in fact, be considered "transversal", as they serve various stages of the production/distribution cycle. Moreover, a number of them are actually used by many sectors of industrial activity, thereby constituting a basic "service infrastructure" for the overall economy, which explains why they are often considered to be sectors of vital national interest. Other services are more specific to particular stages and/or industries (professional services and consulting). Finally, some services do not seem to fit into any of the above categories. For example, tourism has a production/consumption cycle quite distinct from other services, or construction, which is essentially an industrial activity, is considered to be a service on account of infrastructural character and its strong interlinkage with engineering (a professional service).

Therefore, with regard to the position in the production/distribution process, a first major distinction should first be made between infrastructural services (transportation, telecommunications, banking, marketing and distribution, which all have a strong transversal and "distributive" character) and the other more specialized business services (professional and consulting services), tourism and construction being considered further special categories.

B. The factor content

Another major aspect to consider in assessing producer services is the "factor" content of services. Four major factors can be identified: (i) money or finance capital (i.e. disembodied capital); (ii) fixed capital (i.e. capital embodied in physical equipment); (iii) human capital (i.e. capital embodied in people, in the form of knowledge); and (iv) information.[2] These factors are no different from those used in the production of goods, but in services the last two are of particular importance and actually constitute the specific character of services' production and delivery. Each of these factors has different degrees of availability/mobility; these in turn strongly affect both the geography of development, the modes of delivery, and the forms of trade in services. In service policy, taking the factor content into consideration is therefore crucial to assessing possible comparative advantages, development strategies or guidelines for negotiations.

1. *Money capital*

The availability of money capital depends on the level of development of a country and/or its borrowing power. While obviously important for any kind of activity (since it can be used for investment in fixed, human, or information capital, whether in agriculture, manufacturing or service activities), the availability of finance capital is especially crucial in services such as banking and insurance. The mobility of money capital is, in principle, very high, but a number of important national and international rules do restrict its potential mobility, mostly for reasons of national balance-of-payments concerns.

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2 For comments on the a closely related classification of "knowledge", see Raymond J. Krommenacker, "The Impact of Information Technology on Trade Interdependence", *Journal of World Trade Law*, Vol. 20, No. 4 (1986), and Fritz Machlup, *Knowledge: Its Creation, Distribution, and Economic Significance* (Princeton, Princeton University Press, 1980).

2. *Fixed capital*

This is capital embodied in machines and other forms of physical equipment. Although services are generally conceived of as immaterial, their production process is often quite capital-intensive. Industries such as transportation and telecommunications rely heavily on the existence of important physical infrastructure: not only ships, aircraft, satellites, but also airports and port facilities, as well as transmission equipment. Even in a number of consulting services, the availability of new technology equipment (computers) is crucial to do business efficiently.

The mobility of fixed capital varies. For the most part (equipment and machinery) it is embodied in goods which are transportable and which thus can be traded according to the norms regulating trade in commodities. For the rest, however, fixed capital is really fixed, i.e. it must be manufactured and/or assembled and once installed belongs to that place and cannot be moved. In any event, since a large part of advanced technology equipment is not manufactured in developing countries, although tradable, its purchase has relevant consequences on the trade balance of developing countries. It should also be mentioned that a great many services are actually embodied in physical equipment or material inputs, e.g. the software programmes to run a given type of equipment are often stored in the equipment itself (see section I.C below, on modes of delivery).

3. *Human capital*

Human capital can be defined as the knowledge and skills embodied in people. This factor is increasingly vital for a number of business services, i.e. professional services where the delivery of specialized knowledge is the main service output. Knowledge can, in principle, be considered a free good, but in practice it is not, as it depends to a great extent on the socio-economic context (i.e. the learning environment). In particular, although knowledge can theoretically be gained by anybody, its possession is contingent upon the existence of an extended and qualified training system. Moreover, a large part of know-how is not learned from books, but acquired on-the-job, i.e.

"learning by doing", and is hence dependent on the existence and development of specific activities, with specific fixed capital.

Being embodied in people, the mobility and tradability of human capital is, in principle, very high, although restricted in practice by regulations on the mobility of persons and the right to do business (foreign labour legislation, rules of professional associations, licensing regulations, etc.). Transactions in human capital occur in a variety of ways: people from one country may go to learn the business in another country (i.e. absorbing and paying for training in the host country) or people from one country may go to another country to sell their knowledge. The latter form is true of many professional services, when consultants from one country relocate temporarily in order to deliver their service in another country.

4. *Information*

Information is perhaps one of the most difficult of all factors to tackle as well as the most distinctive service production. Indeed, the economics of information is a rather new subject, which challenges conventional economic theory in many ways. At least three phases/components of information can be identified:[3] data, which are the "symbolized" component of information, increasingly produced and transmitted in the form of electronic signals that are "machine-readable"; information itself, which is the combination and/or processing of data in messages not necessarily in machine-readable form: and intelligence, which is the use of information by man in decision-making processes.

Information is an increasingly crucial factor of production in contemporary economic activity, for at least two strongly interrelated reasons: (i) the growing volume of transactions, characteristic of the current phase of world development; (ii) the revolutionary development

3 Constantine V. Vaitsos, "The New International Economics of Major Technological Changes", paper prepared for UNDP/UNCTAD/ECLAC (Project RLA/82/012), Geneva, 1987.

of information technology, i.e. digital transmission and processing of information.

Among the properties of information, the following may be mentioned:

- Its inexhaustibility and non-appropriability, in the absence of institutional constraints. Indeed, the value of information can rise greatly if proprietary devices are established (this aspect is a subject of lively debate as what is theoretically a "societal" resource, i.e. a public good, can be transformed into a "tradable" commodity);

- Its immaterial quality, although it is essentially an entity rather than a process;[4]

- The fact that it is imperishable, storable and transmittable;

- Conversely, because it must be stored, it is usually embodied in other factors; and

- Its growth as an input not only in its own production process, but also in the production/distribution process of numerous other activities.

This last property actually explains the pervasiveness and transversal impact of NIT (see section II.A). Not only does the transmission of information feature a family of services *per se* (telecommunications), but a very large part of other producer services have data and information as their main factor - and often product - of activity (data storage and processing, software programming, technical engineering); for many others, the transmission and processing of information is a major medium through which business is generated. Brokerage or marketing services, for example, deal with the timely processing and transmission of information between suppliers and customers. In transportation (e.g. computerized reservation systems) and in several consulting services the gathering, processing, and transmission of information has become a vital component of business.

4 *Ibid.*

Precisely because of technological progress, information in data form is, in principle, a highly free and mobile factor. However, a number of constraints limit the availability and use of data - for example, (i) the need for expensive equipment to store, read, process and transmit information; and (ii) rules that transform information into a lucrative trade. The latter is a rather critical issue, because only through proprietary and other forms of control is the societal resource information transformed into a tradable commodity, with barriers to entry.[5]

In conclusion, the varying weights of the above factors in the production/delivery process of services are important in explaining development patterns and in formulating development and trade strategies. For services such as transportation or telecommunications, the large fixed-capital investment outweighs human-capital requirements; in others, such as banking or insurance, the crucial constraint is availability of money capital; in certain consulting services, human capital is more important than fixed capital. Access to information is increasingly important in all sectors, but particularly in distributive and marketing services. A careful investigation of the factor requirements of different services is thus rather important in assessing existing and potential comparative advantages among countries.

C. Modes of delivery: flows and trade in services

The factor content of services production and its allocation across countries is closely linked to the way services are delivered, i.e. the patterns of service transactions and trade. Before discussing these issues, however, it is useful to distinguish betwen: (a) service flows or transfers, i.e. the way a service (value) is transferred (added) to its user (production), and (b) service trade, i.e. the actual billing and payment for such transactions. In fact, several modes of delivery exist, but what matters is that different acknowledgements are ascribed to such transactions. In many cases, service flows are not considered transactions (e.g. intra-firm and intra-border transfers); in other cases, they are either not accounted for or not considered true trade (e.g. intra-corporate, cross-border flows or factor movements).

5 *Ibid.*

Conceptual problems stem from the structural difficulties involved in assessing the flows and value of service transactions in general. Services provide intermediate labour inputs, i.e. value added, that often do not exist or can be stored separately from the relevant good or activity. They are thus embodied in the activity or product with which they are delivered and whose value they increase without necessarily being recorded in accounting systems as service value added.

Moreover, trade theory is generally concerned with trade in outputs not in inputs; in other words, the concern is with trade in goods and "non-factor" services rather than with international movements or earnings of factors of production (intermediate inputs, labour and capital) i.e. "factor services". Thus, in terms of balance-of-payments accounts, the theory of international trade concerns itself with activities reflected in receipts and payments on account of the exports and the imports of goods and non-factor services, and not with capital account, factor incomes (interest and dividends) or labour remittances.

In this regard, the question has been raised as to the appropriateness of distinguishing between factor and non-factor services, i.e. between the labour component of value added (a factor service) and labour services purchased as intermediate inputs from another firm (non-factor services). So as to illustrate this point, a typical example may be given of a professional person from country A who renders a factor service when going to country B as a consultant, but contributes a non-factor service if he or she does the same work as an employee of a firm in country A which sells information under contract to its customer in country B.[6]

Trade in services is thus usually defined as the cross-border payment for services provided by the resident or firm of one country to a resident or firm of another. However, the picture is more complicated. Unlike trade in goods, because of the peculiar nature of service transactions, such payments only rarely feature the cross-border movement of actual service output. Payment transfers from one country to another also occur through the cross-border movement of the consumer to the country of production (e.g. tourism or training), through the

6 H.D. Arndt, "Comparative Advantages in Trade in Financial Services", *Banca Nazionale del Lavoro Quarterly Review*, 164 (1988).

cross-border movement of the supplier to the country of consumption (e.g. in many professional or consulting services), or through the cross-border movement of fixed capital and/or goods in which they are embodied and to which they add value (transportation, telecommunications, brokerage).

In this regard, it has been argued that no trade in service output can actually occur *per se*, since services are by nature always embodied in people or materials.[7] Moreover, service production is increasingly split into distinct phases which follow different transaction forms, often featuring mixed modes of delivery. Thus, service transactions can occur in different forms and at different points in space. The following classification of delivery modes partially follows that of Grubel, although with substantial conceptual differences.

1. Cross-border movement of consumers

(i) People move abroad to consume services within the producing country. (This is typically the case of tourism, training and education.)

(ii) Capital goods move abroad to incorporate services. This is the case of repair and maintenance of transportation means and other machinery (e.g. Singapore and Malta have exploited their location at the crossroads of major commercial trade routes to sustain ship, and recently aircraft, repair and maintenance activities).[8]

(iii) Intermediate and final goods move abroad to incorporate services. This is the case of "entrepôt trade", i.e. storage and wholesale intermediation activities in the transportation/distribution chain (Singapore is again an example of such specialization, but most storage and trade intermediation of developing countries' exports occur in the country of final distribution). Other examples include that of electronic data entry, i.e. the recording of in-

7 Herbert G. Grubel, "All Traded Services are Embodied in Materials or People", *The World Economy*, Vol. 10, No. 3 (1987).

8 *Ibid.*

formation on various electronic supports (a growing industry in some South East Asian countries), or custom software production (e.g. India for the United Kingdom), or electronic printing activities for developed-country publishing houses (e.g. Taiwan, Province of China).

2. *Cross-border movement of factors of production*

(iv) People (more or less temporarily) move abroad to sell services. This is certainly the case not only of construction workers or shipping crews, but also (and increasingly so) of consulting specialists, teachers and academics. It is a clear case of service trade which is seldom acknowledged as such, being most often considered a factor service or labour remittance.

(v) Capital goods move abroad to render services. The typical case is that of transportation, where carriers physically cross borders to deliver their service. However, heavy machinery for construction or civil works is also temporarily moved abroad (often with the joint provision of consultancy services), and leasing or renting of transportation means and other heavy equipment is developing as well.

(vi) Capital moves abroad, in the form of FDI, to produce and/or sell services. This is a very special case of factor movement, since it encompasses several elements and involves the establishment of a branch, with a variable amount of fixed, human and information capital, according to whether it is a producing branch or simply a delivering one. The import and domestic share of such factors is actually a crucial element in bilateral agreements on FDI, which has traditionally been considered an issue outside trade regulation. FDI in services has always existed in a number of services, especially trade intermediation and distribution and in certain segments of transportation, but it is a new and growing phenomenon in a number of consulting services, in view of the need to interact closely with customers, at least in the final stage of the production/delivery chain.

3. *Cross-border movements of service output*

(vii) Service output moves abroad to be incorporated by the consumer. This is a clear case, truest in the case of service cross-border movement, generally recorded as trade. However, as one observer noted,[9] in order to be moved the service needs to be embodied in some entity or be carried on by a physical support/vector. This has traditionally been the case of many consulting service outputs which cross borders in the form of paper (reports, plans, drawings, legal documents), tapes or discs (music and motion pictures, software and data) comprising customized scientific, professional and artistic knowledge, information and data. Current statistical conventions consider these cross-border movements of "goods" as trade in non-factor services, on the basis of their very high ratio of service value added compared to that of materials. However, it is not clear why, then, goods such as customized hardware (e.g. chips or microprocessors), which embody a high share of scientific value added, are still considered manufactured goods.

With regard to the cross-border movement of service outputs, a debated issue is whether or not the transmission of information through telecommunication should be treated separately. When transmitted, the information is not embodied in a material good, but consists of electronic signals propelled by physical equipment (e.g. voice telephony).

4. *Intracorporate cross-border movements of services*

(viii) Service output or factors move abroad within the corporate structure. This is a very important form of service transfer, rarely recorded as a transaction and most often not counted as trade at all. It raises the very important issue of "implicit" versus "explicit" service transactions.

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9 *Ibid.*

Internal service transactions, i.e. services carried out within the boundaries of any type of firm, are very difficult to record and are generally not accounted as service value added, but as value added to the sector of final products. Only in services that are externalized (i.e. provided by an independant service firm, when transactions between the supplier and the receiver of services become explicit) is value added recorded as service value added, and true trade between different economic units eventually occurs, whether domestically or internationally. Not counting a domestic intracorporate service transaction translates only into a lower estimated share of services in GDP, but when cross-border intracorporate flows are involved, it is trade in services that is actually underestimated.

Regardless of whether they are in manufacturing or services, TNCs transfer abroad a great deal of services within their own corporate boundaries, providing foreign subsidiaries with firm-specific assets, such as technological and marketing know-how, as well as managerial, financial and accounting services, which should be regarded as trade flows.[10] It has actually been proposed to consider returns on FDI as a proxy for evaluating internalized service trade as they reflect payments for proprietary knowledge of TNCs, and to include them as a category of trade.[11] As will be discussed later, this mode of service delivery has rather important implications with regard to host-country development, since it features an "exclusive" cross-border transfer and use of proprietary know-how and firm-specific services, often through a private infrastructure which is not available as "externality" to other local users.

In conclusion, there are multiple and often overlapping forms of service delivery, not all of them accounted for or considered as trade in the narrow sense, as they involve the movement of consumers or factors, rather than of actual service output. In some services, one form of service delivery prevails (either because it is more efficient or more profitable), whereas in others several forms of delivery are practised simultaneously. NIT actually enhances economies of scale and scope in

10 See Sanjay Lall, "The Third World and Comparative Advantages in Trade Services", in S. Lall and F. Stewart (eds.), *Theory and Reality in Development: Essays in Honor of Paul Streeten* (New York, St. Martin Press, 1986). See also Alan M. Rugman, "Multinationals and Trade in Services: A Transaction Cost Approach", *Weltwirtschaftliches Archiv* Vol. 123, No. 4 (1987).

11 Rugman, *op. cit.*

the service sector, thereby allowing a further segmentation of the production process into phases which may take place at different locations. Different modes of transaction can thus be found within the same service production/delivery chain.

The way delivery modes are structured is particularly important since it also affects the location of service suppliers, i.e. the place where value is added and retained (see section II). A careful assessment of more efficient or desirable modes of delivery is thus crucial to designing good development strategies.

D. Structure of supply and markets

The structure of services supply is quite varied. It is influenced by several factors, either on the supply side (technology and organization of the production process), or on the demand side (size, structure, and characteristics of markets). The industrial structure, in turn, affects the geography of services supply.

As has already been mentioned, services can be provided internally or externally. With regard to internalized services, i.e. services provided within the corporate structure by specialized personnel, departments and branches, their importance vis-à-vis free-standing services is difficult to measure. It is nevertheless widely acknowledged that internalized services have mostly developed within large, complex corporations and that they tend to cluster near headquarters. They thus tend to concentrate in a few central metropolitan areas, on both the national and the international scale.[12] As will be discussed later, a distinctive feature of such internal service activities is that they are produced and consumed only within the corporate structure and are therefore not directly available to the surrounding economy.

In the case of external, free-standing services, the supply structure varies across industries. In some instances they are highly concentrated (often with monopolistic characteristics), whereas in others they present

12 See Flavia Martinelli, "Une approche théorique de la demande de services aux producteurs", in F. Moulaert (ed.), *La production des services et sa géographie* (Villeneuve d'Ascq: Presses de l'Université de Lille I, 1988). See also Flavia Martinelli, "Services aux entreprises et développement régionale", in *Ibid.*

a more competitive structure. Moreover, they can be privately or publicly owned and/or operated. Many infrastructural services (banking, insurance, transportation, telecommunications, distribution) which are also the oldest free-standing services in the economy, show a rather concentrated industrial structure at the national level, owing to the large economies of scale involved in their production, often coupled with national security and public interest concerns.

Transportation and telecommunications, in particular, have often been considered "natural" monopolies and in the majority of both developed and developing countries are either directly supplied by a State monopoly or, if private, heavily regulated by the government. Certain ancillary services may, however, be performed by smaller, private firms.

Banking and insurance, although strictly regulated, are traditionally private and show a rather "oligopolistic-competitive" structure,[13] i.e. they are dominated by a few large firms, mostly national but increasingly transnational, with only a small share of aggregate activity carried out by smaller firms, generally in specialized niche markets.

Trade intermediation, i.e. brokerage and wholesale distribution-related activities, are generally less concentrated, although significant examples exist of large firms and a trend towards increased concentration is observed. It is also worth mentioning that a number of these marketing/distributive activities are actually internalized by large manufacturing companies. This is the case, for example, of major food-processing TNCs importing agricultural staples from developing countries, or of computerized reservation systems in air transportation, which are partly internalized by airlines. In a number of countries, particularly for crucial export staples, State trade organizations have also been set up. In all the above services, a significant and growing share of operations is carried out by TNCs, although they are often limited by State regulations. Business and other professional services, in contrast, have traditionally exhibited a more diffused industrial structure both at the international and the national level, although cases of large firms could also be found. This has been mostly due to the rather customized nature of these services, as well as the need to interact

13 Arndt, *op. cit.*

closely with clients, which involves an atomistic supply, oriented to local markets.[14]

However, with the quasi-elimination of distance as a concern and the "industrialization" of services production or phases of it allowed by NIT development, the productive organization of many professional services is undergoing a profound transformation. Large national and transnational service corporations are emerging, often supplying a diversified, albeit integrated, range of products.[15] In contrast to other processes of industrial concentration, the current growth of corporate size in these industries (through acquisition, mergers, or direct investment) seems to accompany physical dispersion of operations, since branches may be kept open in less central regions.

Two aspects, however, should be noted with regard to this phenomenon:

- First, a hierarchical structure of delivery is emerging within the corporate structure, since the more peripheral branches are often only subprocessing or simply "sales" branches, depending on central headquarters for top level knowledge and information transfers;

- Secondly, such a structure of supply is distinctively different from earlier intracorporate service flows, since final services are actually sold on the open market of the host region and, although competing with domestic supply, they do become an "externality" for the overall local economy.

The above general characteristics of supply translate into a still quite polarized geography of producer-service production - i.e. a spatial

14 T.M. Stanback Jr., P.J. Bearse, T. Noyelle and R.A. Karasek, *Services: The New Economy* (Totowa, N.J., Allanheld Osmun, 1981).

15 See UNCTC, "Role of Transnational Corporations in Services, Including Transborder Data Flows", (United Nations Publication, E/C.10/1987/11). See also Thierry Noyelle, "Professional Business Services and the Uruguay Round Negotiations on Trade in Services", in UNCTAD, *Trade in Services: Sectoral Issues* (United Nations Publication, UNCTAD/ITP/26), pp. 309-63; and Frank Moulaert, Flavia Martinelli and Faridah Djellal, *The Role of Information Technology Consultancy in the Transfer of Information Technology to Production and Service Organizations*, Werkdocument 10 (The Hague, Nederlandse Organisatie voor Technologisch Aspectenonderzoek (NOTA), Hague, 1989).

concentration of service activities in a few central regions - both at the international and national levels. At the international level, the protectionist action of nation States in major infrastructural services such as transportation, communications and banking has determined a more diffused international division of labour (although the majority of developing countries still run a deficit in many of these services) and has also favoured monopolistic or oligopolistic national structures. The same international pattern may be observed in a number of professional services (e.g. legal services), sheltered from international competition by national licensing norms. However, within each country the structure of many professional services is often quite fragmented. In some of the most advanced and specialized business services, which are less regulated than the more traditional professional services, the international geography is extremely polarized, with a strong concentration of production in developed countries alone.

The overall concentration of producer-services production in industrialized countries is mostly a consequence of the "symbiotic" character of services and production development. Industry is the market for services as services themselves are an outcome of the finer technical and social division of labour proper to advanced economies.[16] Further developments in service production have also been spurred on by NIT, which originally evolved in the R & D centres of the manufacturing industry of advanced economies.

Initially geared to the domestic market, producer-service firms in these countries are now increasingly concentrating and expanding their business across borders, exploiting their know-how and specialization. (See section II.B below.) Trade as well as FDI in services, although still a small share of the total, is in fact recording very high rates of growth.[17]

16 Martinelli, "Une approche", *op. cit.*

17 Karl P. Sauvant and Zbigniew Zimny, "Foreign Direct Investment in Services: The Neglected Dimension in International Service Negotiations", in UNCTAD, *Services and Development Potential: The Indian Context*, (United Nations Publication, UNCTAD/ITP/22), pp. 71-112.

II. PROBLEMATICS OF TRADE AND DEVELOPMENT IN SERVICES

The major "structural" parameters discussed in the preceding section constitute a preliminary conceptual grid or working tool with which to approach the strategic and negotiable implications of individual services. However, these parameters must be seen in combination with a number of emerging contemporary issues of great relevance to services trade and development: (a) the close link with and impact of NIT; (b) the existing and prospective comparative advantages in services production/delivery; (c) barriers to entry; (d) international division of labour and of service value added. This section will examine how trade in services, foreign direct investment, and the development and transfer of NIT are closely interrelated, with an increasingly cross-sectoral set of problematics.

A. NIT and its consequences on production and trade in services

The following passage synthesizes quite well the elements involved in the rapid development of new information technology:

> Energy experts from Tokyo to Athens trace oil shipments by consulting a computer data base in Houston. The fire brigade in Malmo, Sweden responds to a fire alarm by consulting a computer data base in Amsterdam on the most efficient route and the closest fire hydrant. Lawyers in the U.S. consult a computer data base containing abstracts of American law cases summarized in the Republic of Korea. And a computer in San Francisco schedules global movements of the engineers, bags of cement and giant construction cranes that are needed to build airports in Saudi Arabia."[18]

Generating, processing and distributing information has indeed become a major and pervasive contemporary activity. The term "new information technology" (NIT) generally refers to a cluster of converging production and service activities, encompassing microelectronics,

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18 Geza Feketekuty and Johnathan D. Aronson, "Meeting the Challenges of the World Information Economy", *The World Economy*, Vol. 7, No. 1 (1984).

communications and the treatment of information. It can be defined as: generating, converting, storing, processing, transmitting and/or controlling information.[19] It is produced with a combination of several different factors: know-how, information, software, hardware, "orgware".[20] The merging of these different elements explains the close link between the economics of information, the economics of services, and the economics of innovation.[21]

Among the most widely acknowledged characteristics and effects of the development of NIT in the contemporary economy, the following may be mentioned:

(a) Although the impact of NIT on production technology is significant, its most pronounced effect is being observed in the management of production itself and in service activities, i.e. all those activities concerned with flows and processing of information, where NIT has dramatically reduced transaction costs ("a collapse in time and space")[22] and has spurred quite radical changes in the economics of production relations. This particular aspect of NIT emerges clearly when it is compared with other major technological innovations of the past, which mostly affected material production.[23] As an illustration of this, the airline Air France in the early 1980s planned to invest billions of dollars in its telecommunications and computer facilities, much more than in actual aircraft.[24]

(b) NIT is quite pervasive in character and has a wide transversal impact on the organization of production and distribution, affecting nearly all sectors of economic activity. While the development of NIT has created a number of specific new products and services (computers and telecomunications equipment, along with data processing, new technology consulting, software programming,

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19 Krommenacker, *op. cit.*

20 By analogy with software and hardware, "orgware" stands for organizational and strategic management.

21 Krommenacker, *op. cit.*; Moulaert, et al., *op. cit.*

22 Vaitsos, *op. cit.*

23 Stanback, et al., *op. cit.*

24 Feketekuty and Aronson, *op. cit.*, p. 63.

etc.), it has also revolutionized the way existing production and services are carried out. For example, quite relevant changes have occurred in trading itself, i.e. the management of purchases and sales. On the one hand, this transversal impact involves a further technical (and social) division of labour (such as the separation of digital entry data from information processing or software programming). On the other hand, it also involves a "resynthesis" and/or integration of previously separated production and exchange relations. (Examples include integrated-service digital networks, the resynthesis of voice, data and typing operations or of accounting, billing and management reporting, the integration between financial, insurance and brokerage activities, etc.).[25]

(c) Thus NIT enhances the growing interdependence of contemporary economic activity, whether among phases or firms within production processes or between production and services, long distance (remote access) or short distance (resynthesis). This also means increasingly strong integration and overlapping between technology, production and services, blurring the traditional sectoral differentiations. An example is the growing integration of technology and services in telecommunications: a videotex terminal represents a synthesis of telecommunications, computers, broadcasting, printing and information-gathering services. In the same way, the sales of certain hardware increasingly involve the joint sale or production of software, training, and maintenance.[26] In many cases, NIT has even substituted older services (e.g. electronic mail).

(d) With increased storability and transmission of information, NIT has greatly enhanced the transportability of services, or parts of the production cycle, thereby significantly altering traditional modes of delivery. This often translates into an increased tradability, although, as has been noted, transportability is a physical attribute, whereas tradability is an "economic" concept, subject to corporate goals and conduct, market structures and in-

25 Juan Rada, "Information Technology and Services", mimeo, 1986.

26 Vaitsos, "The New International Economics", *op. cit.*; Moulaert, et al., *op. cit.*

stitutional practices.[27] In particular, NIT has significantly relaxed one of the key properties of service production, i.e. the fact that production and consumption of a service have to be carried out simultaneously in the same place. The possibility of storing a significant part of "intermediate" service inputs in the form of information so as to transmit it quickly upon demand has allowed the separation of significant segments of services production from the time and place of delivery (e.g. remote data entry and processing in insurance).[28]

(e) By increasing the scope for co-ordination of diverse inputs in order to deliver the final product at distant locations, NIT has, among other things, favoured a process of industrialization of service production. Large-scale organizations are learning to exploit the increased scale and scope economies involved in the production/delivery of services and of integrated goods-services packages, as witnessed by the growing industrial concentration even in formerly fragmented service industries such as professional services.[29] It has been noted that that the assumption of a competitive and locally oriented structure of services production is increasingly weakened.[30] A new international division of labour in services production is taking place. It is led by TNCs, with centralized decision-making headquarters which co-ordinate widespread and distant operations, many of them simply "delivery" branches.[31]

(f) Finally, NIT is often regarded as a powerful enabling factor for the better diffusion of information as a truly "free good", thereby enhancing competition among firms. Although certainly less prone to be exclusively appropriated than other factors of production, the free circulation of information is nevertheless restrained by a number of factors: (i) specific capital equipment is needed in order to read, store, process and transmit digital infor-

27 Vaitsos, *op. cit.*

28 Rada, *op. cit.*

29 Noyelle, *op. cit.*; Moulaert, et al., *op. cit.*

30 Stanback, et al., *op. cit.*

31 Noyelle, *op. cit.*; Moulaert, et al., *op. cit.*

mation; (ii) the actual "access" to information may often be protected by a number of proprietary devices. Rather than promoting competition, such constraints can pose significant barriers to entry. This is a particularly crucial issue, since it strongly affects the potential of NIT to aid the development process, e.g. diffusion versus further polarization.

B. Comparative advantages and international competitiveness

Both nations and companies need to adjust rapidly to new developments in technology and organization if they are going to survive in world competition and succeed in the current restructuring of the international division of labour. In other words, they need to anticipate what their comparative advantages will be. These advantages, however, are not "natural" anymore, but increasingly institutional.[32] As such, they are also dynamic rather than static in character.

Comparative advantages are generally defined as the endogenous particular conditions and/or factor endowments which allow any one country to produce a given product or service at cheaper costs and/or with better quality than another country and hence sell its product to the latter country. Trade theory seeks to explain the development of industries and patterns of trade as determined by comparative advantage. Hence it is not concerned with the movement of factors, particularly of investment, which is the proper object of location theory. It does not, therefore, investigate why companies would establish subsidiaries in a foreign country rather than export products and services from the home country.

Although traditionally developed within the same neoclassical framework, international trade theory and theories on the movement of factors mostly ignored one another. Nevertheless, the two theories are quite complementary. Their points of similarity increasingly overlap, especially in the case of services.[33] As mentioned earlier, the movement of factors is a rather important feature in service trans-

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32 Vaitsos, *op. cit.*, p. 24.

33 Arndt, *op. cit.*

actions, the conditions which make a country a major exporter of services often make that same country a major source of FDI and factor movements. However, a number of other issues further complicate a straightforward analysis of comparative advantages as defined in neoclassical theory.

In the simplest Heckscher-Ohlin type of analysis, comparative advantages are the product of relative endowment in two elementary factors: capital and labour (with the possible addition of natural resources). Consequently, the international division of labour will reflect the relative capital- or labour-intensity of industries. However, comparative advantages are dynamic: they evolve with progress in development and technology. Thus, at any one time, comparative advantages are determined by endowments resulting from a previous round of accumulation and development patterns, as well as from their particular fit with new organizational and technological paradigms.

Contemporary work on the issue has shown, moreover, that capital and labour are not monolithic, undifferentiated entities but strongly influenced by institutional aspects. In particular, labour embodies skills and knowledge (the human capital factor) that may be highly differentiated and influenced by the existing technological and industrial environment. As for the information factor, it is seldom acknowledged (and is difficult to measure), although its role in services production is critical.

It should also be noted that the concept of comparative advantage stems from the "normative" theory of international trade, which postulates that free trade enhances global welfare. It has been argued, however, that global welfare may sometimes conflict with the welfare objectives of individual nations. The issue of gain should thus be more precisely restated: a country gains from importing services or allowing the immigration of factors only if the terms of such transactions are more favourable than the terms in the domestic sector.[34] Furthermore, following the same argument, it has been rightly pointed out that gains cannot be calculated solely in terms of price differentials since much wider effects are involved in the development of a domestic sector, such

34 Brian Hindley and Alasdair Smith, "Comparative Advantages and Trade in Services", *The World Economy*, Vol. 7, No. 4 (1984).

as backward and forward linkages and cross-sectoral "synergies". This reiterative effect explains why trade restrictions and protectionist measures by national governments have always existed.

In fact, international trade does not occur in a competitive economic environment. Economies of scale and institutional factors which sustain the development of monopolies or oligopolies significantly alter the bases of the theory of international trade and of neoclassical comparative advantages. Such scale economies not only affect production costs (i.e. price competitiveness) but also, and more importantly, affect access to and control of markets (i.e. market power). Such "distortions", as will be stressed in the next section, are also treated under the heading of "barriers to entry" or barriers to free competition.

In conclusion, however far one may stretch the Heckscher-Ohlin factor-proportion argument, "natural" endowments do not adequately account for a number of comparative advantages. "Man-made" conditions and resources influence trade patterns to a greater extent. Among these, political and economic stability, existing infrastructure (of basic and complementary services), economies of scale and government intervention are crucial elements, as they strongly affect investment decision, the development of skills, and the creation and diffusion of information. This is why, in discussing comparative advantages, it is useful to separate the determinants of trade patterns into two divisions: (a) basic determinants of comparative advantages in a competitive market; and (b) the effect of so-called distortions, i.e. of market power and government intervention.[35]

In the case of services and new information technology, and in the light of the main factors of production outlined in the previous section, the following comparative advantages can be considered: (a) the endowment in know-how and skills; (b) the amount of existing physical infrastructure, i.e. the stock of fixed capital, including high-technology equipment; and (c) information capital, i.e. the amount of elementary and processed information stocked.

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35 Arndt, *op. cit.*

These factors are clearly not "natural". They are the result of the level and pattern of prior development. Their relative endowment is thus a function of the following: (i) the amount of resources invested in R & D and education; (ii) the existing industrial and technological development; and (iii) State regulations. Thus, it is easy to predict that developed countries have and are likely to retain their prominence in the production and trade of services and technology, thanks to their technological lead and their abundance of physical and human capital. Such hypotheses have been tested with an econometric model,[36] and the results strongly support the importance of money capital and human capital in the specialization of advanced economies.

However, a large part of the comparative advantage of developed economies remains unexplained.[37] The factor-endowment argument must be extended to integrate institutional aspects, which introduce relevant distortions: (d) the size of suppliers and the size of markets (i.e. economies of scale in production and delivery); (e) economies of specialization (also related to the size of markets), which can increase the comparative advantages of suppliers through the accumulation of specific know-how and contact information; and (f) the role of State regulation in furthering or preventing such economies of scale.

Scale economies appear particularly significant in a number of basic infrastructural services (transportation, finance, communication) which also require large capital outlays. Economies of scale appear less relevant in more customer-oriented professional services, where the specialized nature of the service provided, the need for close interaction between supplier and user, as well as the less capital-intensive process of production, have so far usually commanded a more fragmented and competitive structure of supply. Indeed, because of their economies of scale (and other considerations), sectors such as transportation or telecommunications have often been considered natural monopolies and in most countries they are in fact a government monopoly. As already mentioned, even in more fragmented service sectors the development of NIT has increased the importance of scale economies; it has enlarged the scope for industrial concentration, and favoured the emergence of

36 A. Sapir and E. Lutz, "Trade in Services: Economic Determinants and Development-related Issues", *World Bank Staff Working Papers*, 480 (1981).

37 See Lall, *op. cit.*

large transnational organizations, by permitting the physical separation of different phases of the services production/delivery process. It is important to stress that such distortions or barriers to free competition are of both a government and a corporate nature, as will be discussed in section II.C.

Skills and information empower a crucial competitive advantage in the majority of services. These are not undifferentiated factors. They are often "sector-specific" and gathered on the job. They thus give a comparative advantage of those advanced nations which have first developed such sectors (often for the domestic market) and have then been able to expand their business further with exports. Even in sectors such as shipping, where comparative advantages are traditionally identified with endowments in the capital factor, the accumulation of sectoral knowledge, specialized information and "contacts" constitutes, over time, a powerful competitive advantage. According to statistics on shipping, the United States, although better-endowed than Japan or the United Kingdom, seems in fact to be in a much weaker competitive position.[38] This would imply that the highly "specific" nature of skills and information can actually evolve into a barrier to new entrants.

Government action can influence such patterns. Thus, while shipping industries first developed (and are often still dominant) in countries with considerable foreign trade (their large home market having provided a natural base for them to compete in exporting shipping services), other countries (for example, Greece or Norway) have specialized in shipping far beyond their domestic demand, building on their accumulated sector-specific know-how and contacts to extend such services. Still others (such as Panama and Liberia) have managed to secure shares of the international market and foreign exchange currency from the provision of flags of convenience.[39]

Beyond the traditional factor-endowment and factor-proportion arguments, the existence of a large domestic market, the accumulation of sectoral know-how and information, as well as institutional (gov-

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38 *Ibid.*

39 Arndt, *op. cit.*

ernment) measures are likewise crucial to explaining trade in financial services. The reason why countries with abundant capital have comparative advantages in trade in financial services is not based solely on the fact that the banking industry is capital-intensive. While it is true that comparative advantages in financial intermediation have arisen where there was an initial concentration of wealth giving rise to the development of a domestic banking system and capital market, the source of comparative advantage to abundance of money capital, but rather to the presence of the large domestic market itself, which fostered the development of the industry and the consequent development of scale economies and specialized skills.[40] While a number of countries (e.g. France, Germany, United Kingdom and the United States) are leading exporters of financial services which were first founded on home market demand, others such as Hong Kong, Luxembourg, Singapore and Switzerland have developed such exports far beyond their domestic demand.[41]

To explain contemporary comparative advantages thoroughly, one must consider "man-made" conditions and resources, such as political and economic stability favourable for efficient performance, as well as a good infrastructure supplying basic and complementary services (e.g. Hong Kong had an advantage over Singapore in developing loan syndication because it had the necessary legal expertise but lost some of its comparative advantages in the 1980s partly because of political uncertainty).[42]

In concluding the discussion on comparative advantages in services, it should be stressed how, more than in the case of goods, the competitiveness of service products is not solely a question of price, but rather quality and effectiveness. In the production and delivery of many consulting services, for example, technical know-how alone may not be enough. Other crucial elements are close knowledge of the local institutional and economic context, as well as the capacity to adapt the service provided to the customers needs. These considerations have

40 *Ibid.*

41 *Ibid.*

42 Arndt, *op. cit.*

important consequences for the role of comparative advantages in the field of services.[43]

In this regard,[44] a number of elements have been isolated which may alter the seemingly inevitable comparative advantage of advanced countries in the production and delivery of services. They mostly concern the human capital factor.

Firstly, even in knowledge-intensive professional and consulting services, skills developed in developing countries may be more specific to their problems, i.e. more apt to match the needs of service in a relatively less advanced context, thereby competing favourably with services provided by a foreign supplier, unfamiliar with such issues. Service trade among developing countries can thus successfully develop. Secondly, developing countries can still exploit the edge they have in terms of traditional comparative advantage in labour costs, both in less skilled and in more advanced services, thereby eroding shares of the developed world market. In technology-related services, for example, many of the more industrialized developing countries (e.g. Brazil, India, Mexico and the Republic of Korea) already export a significant share of civil engineering services, technology engineering and consultancy, and even computer software.

To sum up, skills and know-how in service production by developing countries can be of three types:

- Competitive with analogous services provided by developed countries, either because they are better tailored to local needs or cheaper, or both;

- Complementary to services sold by developed economies, i.e. value added locally to services provided by developed countries, through various forms of subcontracting, partnership, or distributional arrangements (e.g. construction supervision in civil engineering, installation and training in the sale of capital equipment). This type of specialization is particularly useful in those

43 Jacques Nusbaumer, *The Service Economy: Lever to Growth* (Norwell, Ma., Kluwer Academic, 1987).

44 Lall, *op. cit.*

service industries where high capital investment is needed to enter the market as suppliers of integrated packages;

- Non-competitive services, i.e. services provided to specific market niches where developed countries are not equipped or not inclined to enter.[45]

In contrast, developing countries are not likely to emerge as exporters of highly capital intensive service industries (e.g. shipping), not only because of capital requirement, but also because of barriers to entry due to the scale of activity of the existing suppliers.[46]

C. Barriers to entry and trade "distortions": the emergence of TNCs and their relationship to national regulation

At the heart of the debate between developed countries and developing countries is the issue of trade "distortions", including the "trade restrictive and distorting effects of investment measures" established by national governments. However, as has been noted,[47] distortions and other negative restrictions on trade are portrayed as originating solely in government protectionism - in developing countries - whereas little mention is made of the comparable distorting effect's of TNCs and of developed-country governments' strategies.

The same observer[48] rightly notes that contemporary economics is characterized by two major "economic spaces", nation States and TNCs. While two increasingly overlap and contradict each other, the growing transnationalization of corporations greatly reinforced by contemporary progress in NIT is altering the degree of control and the effectiveness of action by States, by definition geared to national development objectives. Although the action space of TNCs is international, TNCs' objectives do not necessarily coincide with those of nation States and indeed often bypass them. The conduct and performance of such large economic institutions in the world economic system by no means reflect perfectly competitive market relations, but

45 See also *Ibid.*

46 *Ibid.*

47 Vaitsos, "Trade-Related Investment Measures", *op. cit.*

48 *Ibid.*

rather the rules and terms set by central commanding bodies, internal to the corporate structure. The concentration of industrial capital and decision-making within increasingly large and complex supranational institutions is actually a very important feature of the new oligopolistic regime of accumulation.[49] The "small size" illusion of the 1970s is increasingly undermined by the growing need for massive capital requirements and complex interdisciplinary work in research and development as well as established organizational and marketing structure to exploit products commercially. Moreover, the rapid pace of technological change requires quick capital amortization; hence the need to block the emergence of new entrants by sheer scale, in order to prolong product life-cycles and to reap the corresponding returns for as long as possible. Its also worth noting that internalization of transactions does not necessarily occur in the traditionally vertically integrated type of structure, but through more complex forms of closely controlled subcontracting, as well as by the development of a transnational system of production and commercial branches.[50] Industrial concentration, and the growing importance of large corporations, is thus a major determinant of trade distortions and barriers to entry, which make it quite difficult for new entrants (especially for developing countries) to break into the existing market.

Barriers to entry vis-à-vis developing countries have actually been first and most successfully enhanced by the governments of developing countries. This is particularly true in the area of new information technology. In fact, in contrast to the ideological shield of deregulation and liberalization, developed countries, especially the first developers of new technology (the United States of America) but also late-comers (e.g. Japan and the countries of western Europe), have used strong government measures so as to promote and protect domestic development in NIT and related services.[51] While in these developed market economies, the concerns of nation States coincided with those of their

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49 Flavia Martinelli and Erica Schoenberger, "Oligopoly is Alive and Well: Notes for a Broader Discussion of Flexible Accumulation", in M. Dunford and G. Benko, eds., *Industrial Change and Regional Development: The Transformation of New Industrial Spaces* (London, Belhaven Press, 1990). See also Vaitsos, "The New International Economics", *op. cit.*

50 Martinelli and Schoenberger, *op. cit.*

51 See Vaitsos, *op. cit.*; Dosi, *op. cit.*

leading corporations, the opportunities offered by economies of scale and scope economies in strengthening market power, also at the international level, most often conflicts with the national interests of less developed countries.

This explains why developing countries are not keen to give up national regulation in a number of sectors. Barriers to entry to developed-country markets already distort the conditions of international trade. Developing countries are entitled to establish analogous measures to deal with such barriers or at least to require regulation to protect their markets or industries: simply liberalizing trade, when differentials in competitive advantages are so high, can in fact only benefit leading countries. Several other general arguments further support government intervention and/or regulation:

(a) the "infant-industry" argument (only if protected from foreign competition in the domestic market can a domestic industry gather strength and acquire the necessary competitive advantages);

(b) the "destructive-competition" argument (in certain basic sectors, competition between several small operators can be more costly than in a monopolistic or oligopolistic structure);

(c) the "cream-skimming" argument (if left to free competition, a number of basic services would be provided only in the more profitable markets).

The structure of TNCs and the internalized flows of goods, services and information across the corporate structure have further negative effects on the capacity of host countries to control their own development path. Knowledge and information, two major factors in the new technological and organizational paradigms, are made unequally available and incompletely mobile. Both developed nations and their TNCs try to keep such specialized resourses as captive as possible, i.e. within national or corporate boundaries. The aim is both to internalize benefits (further accumulation of know how and information) and/or to limit the opportunities of other competing firms to enter their market.

In the case of intra-corporate service flows, the exclusive and proprietary use of such resources is even more negative than for other intermediate inputs because, although they cross borders, such services benefit only operations within corporate boundaries and do not constitute an "externality" for the host economy. Not only do these service transfers correspond to hidden imports for the host country, but they also compete with and/or prevent the development of a local supply by "diverting" a substantial part of service demand from the local market.[52]

It is not surprising that in the area of services and new information technology, a major item of negotiation is regulation concerning intellectual property rights. Behind the maze of technicalities, it would seem that the main issue at stake is the attempt by TNCs operating in new technology to reinforce their comparative advantage, i.e. gain monopolistic or oligopolistic power by covering a wide range of diverse knowledge and information elements under the net of property rights, thereby regulating not only the "source", but also the international "use" of such factors.[53] It is quite ironic that intellectual property rights, i.e. protection of domestic factors, should be seen as a means to promote competition and encourage the growth of efficient firms across borders.

By way of conclusion, however, it is important to point to the inherent contradiction between the need to sell technology and services, i.e. penetrate markets, and the goal to maintain proprietary control over technology and know how. As already mentioned, knowledge and information are harder to protect and control than other factors of production (e.g. software is much more prone to be copied than other technological innovations). Service and NIT firms in developed countries now need to expand their sales beyond the domestic market. Opportunities exist for developing countries to appropriate and further develop some of these services in the course of trade relations. This is why norms regulating FDI, intellectual property rights, technology transfers, and trade in services cannot be completely separated but represent a complex, integrated package of issues.

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52 Flavia Martinelli, "Struttura industriale e servizi alla produzione nel Mezzogiorno", *Politica Economica*, 1 (1989).

53 Vaitsos, *op. cit.*

D. International division of labour and of value added

In the light of the above considerations, the international division of labour at any one time can be seen as partly influenced by comparative advantages: They result from previous rounds of accumulation and they fit with the dominant technological paradigm. But they are also, and to an increasing extent, determined by the unequal power relations in world markets, which affect the terms of trade. The emergence of producer services and the development of new information technology in recent decades have, in principle, introduced a new degree of freedom in the development game. The actual directions of the current restructuring in the international division of labour are however, still unclear. In particular, the potential ″diffusing″ effect intrinsic to new information technology is counteracted by strong trends towards ″polarization″, led by advanced countries and TNCs.

So far, the international division of labour has featured a substantial concentration of both production and consumption of producer services and new information technology in advanced market economies. In explaining this configuration several trends have to be considered.

Firstly, account must be taken of the dramatic increase in the service content of contemporary production,[54] which is only indirectly accounted by the share of producer services in GDP. This hypothesis is supported by the growing value/weight ratio of goods in contemporary production, i.e. the growing value of embodied work, relative to materials.[55] This trend first developed and is still most pronounced in advanced market economies, as demonstrated by a number of studies, despite the fact that not all service value added is accounted as such. A recent study of input/output tables of 26 developed and developing countries showed, in particular, that the manufacturing sector of leading advanced economies made as much as three times more use of business

54 See Martinelli, *op. cit.*

55 Nusbaumer, *op. cit.*

services than least developed countries. Differentials in the use of transportation are likewise very similar.[56]

Secondly, with developments in transportation and communication, together with the rise of TNCs, a growing separation has occurred between material production and service functions (especially, upstream and downstream ones), with the weight of the former (especially in more labour-intensive and/or more mature productions) shifting to less developed countries and that of the latter substituting for the loss of industrial employment in advanced countries. In this configuration, advanced market economies manage to retain the highest value-added activities, which are also those which most influence change (e.g. research and development, planning, co-ordination) and allow control over terms of trade (e.g. marketing and distribution). Developing countries, albeit to different degrees, are left with the least value-added activities in the primary and secondary sectors, which assume truly "captive" characteristics. If the final price in a developed market economy of almost any good imported from developing countries could be broken down into their various value-added components - throughout the conception-production-marketing chain - it is safe to estimate that over half of the total value-added would have been created and appropriated in or by advanced countries. This is admittedly an "educated guess", as little has been done to study the international division of labour from this point of view. Some research conducted in the early 1980s[57] on the marketing and distributive organization of major agricultural and mineral raw materials exported by developing countries showed that only a small portion of the retail price of the final processed product in developed markets was retained by producing countries, whereas most service segments in the value-added chain (brokerage, shipping, insurance, and distribution) as well as a large portion of processing were controlled by firms in importing countries. This is a clear if extreme case, of "captive" production.

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56 Se-Hark Park and Kenneth S. Chan, "A Cross-Country Input-Output Analysis of Intersectoral Relationships between Manufacturing and Service and their Employment Implications", *World Development*, Vol. 17, No. 2 (1989), pp. 199-212.

57 UNCTAD, "Studies in the Processing, Marketing and Distribution of Commodities", TD/B/C.1/PSC/18, 20, 22, 28, 30, 31.

In aggregate terms, the appropriation of service value added by advanced countries is also demonstrated by the strong spatial concentration of many producer services, and especially the newest ones, in the same industrialized countries. Figures on trade, however inadequate, reinforce this hypothesis. The majority of developing countries run, in fact, important trade deficits in services.[58] Shipping is a good example of this. Although developing countries as a whole ship 46 per cent of world loaded goods (in tons), their merchant fleet carries only 21 per cent of world tonnage; the ratio is much worse when a few leading shipping countries such as the Republic of Korea, Singapore and Brazil are excluded from the data.[59]

The geographical polarization of producer services does not occur only in "free-standing" services. Although quantification of the "internal component" of service transfers within non-service firms is difficult, several studies on producer services and TNCs,[60] have shown that intra-corporate services tend to locate near headquarters, where strategic functions are usually concentrated. While vertical disintegration of material production has significantly increased, for many services, especially in TNCs, vertical integration of firm-specific services is still important.[61] Externalization of service functions has occurred only in central areas, whereas the service demand of peripheral branches is still mostly satisfied through intracorporate transfers.[62] In a recent survey of American businesses, sales of selected services by United States based manufacturing companies to their foreign affiliates in 1984 were estimated to be about 2.5 billion dollars, i.e. more than half of total sales in those same selected services by both non-banking service and manufacturing companies of the United States to their foreign affiliates.[63]

58 UNCTAD, *Trade in Services, op. cit.*

59 GATT Secretariat, "Trade in Transport Services", MTN.GNS/W/60, 1989.

60 See Martinelli, "Services aux entreprises et dévéloppement régionale", *op. cit.*, for a survey.

61 Alan M. Rugman, "Multinationals and Trade in Services: A Transaction Cost Approach", *Weltwirtschaftliches Archiv*, Vol. 123, No. 4 (1987).

62 Martinelli, "Struttura industriale e servizi", *op. cit.*

63 Obie G. Whichard, "U.S. Sales of Services to Foreigners", *Survey of Current Business*, January 1987.

Still, a large portion of intra-firm service transfers escapes measurement: this is especially so when access to headquarters R & D, marketing know-how, or planning, managerial and accounting services are considered. Using returns on FDI as a proxy for the value of such transfers,[64] it was estimated that, in 1984, intracorporate transfers amounted to 34 per cent of total service export and formed 19 per cent of total service imports in the United States. It should also be mentioned that even when services are not provided directly through the corporate structure, preferential treatment of suppliers based in the home country occurs. This preference was clearly shown in the UNCTAD studies on marketing and distributive systems in basic staple exports,[65] where the large majority of developed market-economy importers were large, vertically integrated processing or distributive corporations either vertically internalizing the brokerage and shipping activities, or subcontracting them to companies of their home country.

Such a leadership of advanced countries in retaining service value added would not appear to be ready to change, given the strong comparative advantages these countries enjoy in the production of services. A third, more recent, trend is altering this configuration, however. So far, services produced in advanced economies were geared mainly to the needs of their domestic market or of their foreign operations. Now, as in older sectors, producer services are "industrializing" themselves and searching for new markets. With the help of NIT, trade in services (in its various forms) has dramatically increased, first among developed market economies and then between them and developing countries.

A peculiar feature of this new trend is that it increasingly takes the form of FDI in free- standing service activities, especially in financial and professional services. The service sector shows, in fact, the highest growth rates in FDI as compared to other industries.[66] Moreover, foreign direct investments in this sector are reported significantly to exceed trade in services. For example, United States exports of private non-factor services in 1982 amounted to 32 billion dollars, as compared to 183 billion dollars of sales by United States service affiliates abroad

64 R. Man, 1987.

65 UNCTAD, "Studies in the Processing . . .", *op. cit.*

66 See UNCTC, *op. cit.*; Sauvant and Zimny, *op. cit.*

(excluding wholesale trading). In 1984, United States sales abroad of selected services by non-bank American parent companies amounted to 19 billion dollars, of which 14 billion was to unaffiliated foreigners. In contrast, sales abroad by majority-owned affiliates of non-bank United States parent companies amounted to 67, of which 17 billion to was other United States affiliates and 50 billion to unaffiliated foreigners. It is also interesting to note that of all sales to unaffiliated foreigners by both American parent companies and affiliates, only 10 billion dollars worth, were sold by service companies, the rest being supplied by industrial companies.[67]

These decentralization trends (i.e. through the establishment of peripheral branches) certainly respond to the need to establish close interaction with customers in the client country and they do help lessen the strong spatial polarization in services production of recent decades. Most importantly, they represent a major change compared to the earlier internalized service transfer patterns, since they are explicitly geared to serve the market of the host country, rather than just the operations of affiliates. However, given the separation of functions allowed by NIT and the "industrialization" of service production also in customized services, these new trends must be appraised with care. In fact, FDI can produce just "sales" branches, where most of "intermediate" service inputs are imported from the parent company, with again little local contribution to the creation of final service value added.

67 Whichard, *op. cit.*

WOMEN IN SERVICES: ASIAN CONTEXT

*Michiko Hayashi**

INTRODUCTION

Although a large number of female workers in Asia are still engaged in the agricultural sector, the services sector is the largest employer of female workers in the region. In general, women working in the services sector are concentrated in "trade, restaurants and hotels" and "community, social and personal services", and in Asia this trend is more apparent than in the other regions.[1] Women's high participation in these services may be attributed to several factors, including:

- Women's easy access to such occupations as they require little skill input;
- The existence of certain service occupations which are traditionally concieved as women's domain;
- The domination of some areas in the manufacturing sector by men; and
- the high degree of dependence on part-time employment in the services sector.

The occupational structure of women in the services sector in Asia also reflects a stereotypical pattern, with a low level of female participation at administrative and managerial levels. An extremely low proportion

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1 See "Women and Services", in UNCTAD, *1989 World Survey on the Role of Women in Development* (United Nations Office at Vienna, Centre for Social Development and Humanitarian Affairs, ST/CSDHA/6). Comparison was made for Asia, Africa and Latin America.

of women is engaged in administrative and managerial positions in Asian countries, and it appears that the average share of women in the managerial level is somewhat lower than in other regions.[2] The majority of women engage in occupations relating to clerical, sales or domestic service work.

The above observation might suggest that women engaged in services in Asia are mostly unskilled, and that the services sector supports the economic welfare of these unskilled women. This appears also to be supported by employment statistics. This paper, however, attempts to highlight the significant role played by women in the development of the services sector in Asia, and to recall that they also have a high economic stake in the advancement of the sector and in the results of the Uruguay Round negotiations on trade in services.

I. SPECIFIC ISSUES CONCERNING WOMEN IN THE SERVICES SECTOR IN ASIA

One can identify four major areas in the services sector in relation to women's contribution to the sector. These include informal service sector, tourism, labour services and public services. A large number of women engage in these services in order to support the smooth distribution of goods, to provide health and education, and to generate foreign-exchange earnings.

Developing countries, in general, show the presence of a relatively large informal sector, and it is also observed in Asia. Although it is difficult to estimate the number of women working in the informal sector, it appears to be high, since most of the low-income families living in cities could hardly survive without women who contribute to the household budget.[3] These women are usually engaged in trade, specifically in the distribution of foodstuffs in rural and urban areas. Their presence in trade is often an extension of their own work in agriculture, as well as of their duties in the household.[4] It was reported that in the

2 Employment data indicated that the share was less than 1 per cent in a number of Asian countries. See *Ibid.*

3 "Women at Work", *ILO*, No. 2 (1983), p. 16.

4 Susan Joekes, "Women in the World Economy", INSTRAW, 1987, p. 107. This

southern part of Asia, women sell between 70 to 90 per cent of the domestic farm and marine produce consumed.[5] These women, particularly in low-income Asian countries, carry on their trading activities on an independent basis, and they account for a high proportion of entrepreneurs, own-account traders and unpaid family workers. However, they seem to be carrying out their trading activities within some serious constraints. These include the lack of efficient transport and road networks, the lack of education which prevents them from acquiring the basic formal skills necessary for their activities, the inadequacy of market facilities for storage, shelter, sanitation and security, and difficulties in access to credit.[6] Also, new trends occuring in the trade sector - such as the saturation of the sector in urban areas due to rural-urban drift of population, the cumulative effects of increasing injections of capital into the sector, the sophistication of consumer demand and the emergence of men in trading activities - are making competition in the market more difficult for women traders.[7]

In some Asian countries, tourism is one of the major sources of foreign-exchange earnings, and its development has provided employment opportunities for women, particularly in catering, hotel, and entertainment work. There are some drawbacks in the employment gains of women as well. In Asia, it appears that a substantial number of women, including children, are engaged in entertainment work of a particularly degrading kind under onerous or exploitative conditions.[8] Moreover, gains from female employment in the tourism industry tend to be insecure, as tourism is highly seasonal and sensitive to factors such as political and social disturbances. International competition in tourism has also intensified as many developing as well as developed countries are trying to develop their own tourist industry.

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trend is found also in handcrafts and industries. Also, see UNCTAD, *World Survey, op. cit.*, pp. 161-82.

5 *Ibid.*, p. 162.

6 UNCTAD's experience in technical assistance on the national assessments of the services sector found that women selling horticultural products in some Central American village markets are obliged to borrow through the informal sector to obtain their products, at rates often reaching 30 per cent per day.

7 UNCTAD, *World Survey, op. cit.*

8 "Women in a Changing World", *Proceedings of Asahi International Symposium, 23-25 October 1985*, (Tokyo, Asahi Shimbun, 1985), p. 18.

Labour migration is another area where female labour is making a substantial contribution to foreign-exchange earnings. A large exodus of women, particularly from countries in South and South-East Asia to capital-rich countries in the Middle East, was a significant trend in the 1980s.[9] Although the inflows of female migrants to the region have decreased as the oil-induced economic boom slowed down, a substantial number of Asian women continue to work in the Gulf countries. These women are mostly employed as domestic and other unskilled workers, and repatriated upon expiration of contract.

Women in public services such as health, education and social welfare deserve attention as their socio-economic contribution is substantial. The female labour in the public sector is high in countries throughout the region, and the number of female employees in the sector is increasing continuously.[10] However, studies on women in the public sector indicated that a steady increase in the number of female employees in the sector has not been accompanied by a satisfactory increase in their representation at the middle and higher levels. This low representation in statutory categories was attributed to the limited access women have to entry points which are subject to a system of promotion and advancement.[11] With regard to the working conditions of women in public services, special attention should be given to the health of women engaged in health care. A report on occupational health hazards notes that nurses and other hospital personnel are subject to psychological stresses and strains, tuberculosis, and reproductive impairment caused by radiation and chemical substances.[12]

9 In Sri Lanka, which is one of the major labour exporting countries, female labour migrants outnumbered male migrant workers. See Chandra Rodriog and R.A. Jayatissa, "Maximising Benefits from Labour Migration: Sri Lanka", ILO/ARTEP document, RAS/85/009, Paril, 1988

10 ESCAP, *Women's Economic Participation in Asia and the Pacific*, (Bangkok, ESCAP, 1987), p. 237.

11 This is also true in the other sub-sectors of services in the private sector. See "Recruitment, Training and Career Development in the Public Sector", *ILO*, 1983, p. 73

12 "Report of Expert Committee on Occupational Health for Working Women", WHO/OCH/86.1, p. 33.

II. WOMEN IN SERVICES IN JAPAN

It is worth examining the position of women in the services sector in Japan, as the country's economy is highly advanced and some new trends have been observed in female employment. The industrial and occupational structures of female employment in the services sector in Japan do not indicate a signifficant difference from other Asian countries. However, there are some recent trends emerging as a result of technological and social developments in the country. During the 1980s, producer services grew rapidly in Japan, leading the growth of the services sector like in other OECD countries,[13] and job opportunities for skilled women have increased significantly. Also, the declining growth rates of working-age population and new entry to the labour market have intensified competition among firms for recruiting skilled labour force, and this has led to a further increase in demand for skilled female work force. It is envisaged that the demand for workers with knowledge of computer technologies will continue to be strong, particularly in the financial sector, and women who master these technologies will have bright employment prospects. The increase in part-time and temporary workers is a distinctive characteristic of current employment in developed countries including Japan, and this trend is particularly marked among women in the services sector.[14] A large part of the part-time workers are middle-aged women engaged in service occupations in commerce, where tasks were simplified by office automation. For temporary employment, women workers are concentrated in clerical work, although they are also found in knowledge- and skill-intensive occupations such as computer programmers and interpreters. A growth of women entrepreneurs in the services sector has been observed in Japan in the recent years. As service firms generally require little capital investment, it is relatively easy to enter the service market, and a number of women are already successful in establishing their own

13 For more detailed information on the trend of the services sector in Japan, see "Production and Trade of Producer Services in Japan", in UNCTAD, *Services in the World Economy* (United Nations Publication, UNCTAD/TDR/8 Offprint), pp. 156-57.

14 Liba Paukert, "The Employment and Unemployment of Women in OECD Countries", OECD, 1984, p. 51.

innovative service companies.[15] However, some specific barriers for women who decide to become entrepreneurs were identified. These include the following factors: (a) financial institutions providing capital are generally more used to male entrepreneurs; and (b) the special expertise required to run a successful enterprise is obtained partly from previous experience in a high-level job or from a family business which has been traditionally handed down to sons rather than to daughters.[16]

It is certain that the quality of job opportunities for women in Japan has improved, although sex seggregation in service occupations is still quite pronounced. For example, among prfessional and technical categories, about three-fourths of women workers were either teachers or engaged in medicine and health related occupations.[17] Statistical observations of the employment structure indicated that in Japan the number of women employed in managerial and administrative positions was much lower than in the North America, the former representing less than 3 per cent, while in the latter the corresponding figure was about 10 per cent.

III. STRENGTHENING THE SERVICE SECTOR AND WOMEN'S CONTRIBUTION

UNCTAD studies on services, including those conducted in collaboration with developing countries, have stressed the importance of strengthening the services sector in developing countries with the objective of (a) increasing the support of the services sector to economic activities; (b) providing a means for acquiring foreign exchange; and (c) providing greater quality and quantity of employment opportunities. In strengthening women's contribution to such development objectives the following aspects should be taken into account.

The development of basic infrastructural services would be one of the key elements in facilitating women's increased contribution to the

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15 *Report on New Services* (Ministry of International Trade and Industry, Tokyo, 1987), p. 274.

16 *OECD Employment Outlook* (Paris, OECD, 1988), p. 151.

17 See Chapter on Women Workers in Japan, in "Women in the Service Sector" (MAS/WP6(90)1) OECD-CERI, 1990.

economy. Basic infrastructural services such as road facilities, transportation and telecommunication networks are essential to ensure the smooth flow of goods, services and persons. Women who now carry out trading activities in difficult conditions could benefit considerably from the enhancement of such services. The development of day-care services for children and of financial institutions to which women with limited economic resources have easy access should be included in the development plan of infrastructural services. In recognizing the potential of women who are self-employed in the informal as well as the formal sectors, the United Nations Centre for Human Settlements (HABITAT) stressed the importance of: (a) strengthening organizational and managerial capabilities of informal enterprises and promoting relevant skills among women; (b) providing legislative support for the strengthening or establishment of financial institutions, such as credit agencies, co-operatives and building societies, where women can participate on an equal footing with men; and (c) providing non-financial assistance through training and communications directed at both women and men.[18] Effort has been made to establish women's co-operatives for financial services, and it was reported that they have been effective in encouraging women to have their own accounts and in providing financial support to self-employed women.[19]

Many developing countries have recognized the need to formulate specific strategies aimed at increasing foreign-exchange earnings from the services sector. This is particularly true for countries which see little possibility of increasing their earnings from the export of goods, and especially for those countries whose possibility of constructing a development strategy around the manufacturing sector is virtually non-existent. As noted above, women are already playing an important role in foreign-exchange earnings, particularly in tourism and labour services. Asian countries could further explore the possibilities of increasing the export of services such as medical care, education and tourism in which women are major suppliers of labour, by formulating specific market strategies targeted at various segments of the market.

18 "Women in Human Settlements Development and Management", HABITAT, Nairobi.

19 See Suren K. Saxena, "Co-operatives and Women Enterprise Development in India: Note on a Women's Co-operative Bank", in *Transnational Associations*, No. 1 (1990).

For example, tourism could be enhanced through combining medical and education services, e.g. setting up convalescent centres as well as language and cultural courses in resort areas. At the same time, the shift of women working in entertainment of a degrading kind to other occupations could be promoted.

The skill level of women migrant workers should be upgraded in the long run. In developed countries sectoral shortage of labour force due to demographic change has been a serious problem, and it is envisaged that international migration will be an increasingly important source of labour supply, as these countries continuously experience a substantial slowdown in the growth of the working-age population.[20] Japan has also been experiencing increasing inflows of foreign labour, particularly from South and South-East Asia. So far, the majority of Asian women migrant workers have been low-skilled, although in developed countries labour shortages are found in some skilled occupations in the services sector as well as in manual labour. If the negotiations on international labour mobility in the Uruguay Round results in promoting freer trade in labour services on a most-favoured-nation basis, there would be better opportunities for Asian women, both skilled and unskilled, to enter international markets.

In promoting women's participation in the international economy, the issue of social welfare should not be neglected. The majority of female migrant workers from Asia have a limited educational and financial background, and they are vulnerable to working under exploitative conditions.[21] A large number of Asian women are working in the Gulf area currently, and the recent political developments in the region have raised questions concerning their impact on these women in terms of security as well as economic aspects. The inclusion of trade in labour services within an international trade framework would presumably increase the transparency of international labour mobility, and

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20 *OECD Employment Outlook, op. cit.*. It is interesting to note that traditional labour-service exporting countries in Europe like Italy, Spain and Greece recently became net labour importing countries.

21 The case of exploitation on female foreign workers in the entertaiment industry in Japan is a classic exapmle. See Okabe Kazuaki, "Foreign Workers in Japan", in *Shattering the Myth of the Homogeneous Society: Minority Issues and Movements in Japan* ed. David Coates (Berkeley, Calif., Japan Pacific Resource Network, 1990).

national and international surveillance would become easier for relevant institutions. The relocation of women migrants in the home countries upon repatriation also needs to be seriously considered.[22] In the labour-exporting Asian countries, the creation of employment opportunities for these women as well as providing orientation and training programmes to them would be major elements in the promotion of women's greater economic integration.

The development of knowledge-intensive services from which value-added could be obtained is a crucial element in improving the quality of job opportunities and in capturing a profitable part of production. Knowledge-intensive services are growing rapidly in the newly industrializing countries in the region. However, at the same time, these countries are undergoing specific skill shortages in some occupations such as computer-related work and qualified middle-level managers.

The above observations suggest that a continuous effort to upgrade human resources (which takes into account factors affecting the national and the international labour market, e.g. technological advancement and demographic changes) will be one of the most crucial elements in development policies. It appears that those countries which fail to upgrade female labour equally with male would not succeed in achieving their development goals in the long term. The upgraded human capital cannot effectively contribute to the enhancement of the services sector if women who account for half of the population, are neglected from human resource management.

This study attempted to demonstrate that Asian women in the services sector make a significant contribution to the economies of their countries and that they would benefit from the liberalization of trade in services. However, policy-makers as well as relevant national and international institutions should pay particular attention to a possible drawback of the liberalization of trade in services to women in the services sector. A study which examined linkages between the liberalization of international institutions for trade and investment in services

22 C. Rodriog and R.A. Jayatissa, "Maximising Benefits from Labour Migration in Sri Lanka", *op. cit.*, p. 30. Projections on the return flow of migrant labour in Sri Lanka indicates that annual inflow of unskilled workers including housemaids will be almsot 20,000 in 1991.

and the social construction of gender in service occupations cautioned that liberalization might have a counterproductive affect on women in the services sector.[23] The study cited the case of international recruitment of nurses by countries in order to circumvent local professional groups and to avoid the improvement of working conditions. Also, it observed that use of short-term and temporary visas to provide services might serve women negatively. In many countries, it may be socially acceptable for men to work in jobs requiring long absences from home and travelling alone while for women it may not be easily feasible. The capability to accept transfer orders and to take business trips is important for promotion and for career development. The result of negotiations on trade in services will most likely increase cross-border transfer and business trips, and it is possible that this may aggravate gender segregation in service occupations.

The liberalization of trade in services will result in intensified competition among firms and individual service providers. This implies that institutional and individual effort becomes important more than ever to prevent the abuse of international labour mobility by States and employers to circumvent their social responsibilities for women's welfare, and to create an environment where women can participate in competition at the market and career levels. The liberalization of trade in services will be truly beneficial to women with well-balanced policies for the enhancement of the services sector, the development of human resources and the promotion of equal employment opportunities in parallel.

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23 See Stephen D. McDowell, "Gender and the Liberalization of Services Institutions", March 1991.

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TRADE IN SERVICES IN MALAYSIA: CONSTRUCTION AND ENGINEERING, AND MEDICAL SERVICES

*Paul Chan Tuck Hoong**

INTRODUCTION

In recent years, trade in services has come to the forefront of policy-makers' attention, ranking high on the agenda of many international organizations. Service industries have attracted a great deal of attention as one of the major industries which will contribute to the development of the world economy in the twenty-first century.

According to the Ministerial Declaration of the Uruguay Round negotiations on trade in services, the economic growth of all trading partners and the development of developing countries are the final objectives of the negotiations. Arriving at a successful international services consensus requires a clear understanding within each country of the interlinkages between services and other sectors of the economy, of the country's competitive position, and of the impact of changes in the international policy and regulatory environment in the national development of the services sector.

The countries in the Association of South-East Asian Nations (ASEAN), with their high growth potential, are important recipients of the services sector. However, except in Singapore, the services sector in the ASEAN countries has not received the priority it deserves. Thus, although services have been included for the first time in the new round of multilateral trade negotiations, not all ASEAN Governments have formulated a coherent view of the position, role and impact of the ser-

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vices sector as an integral component of their national production and trade strategies. To date, various elements of the services sector - for example, banking, insurance and tourism, are conventionally treated as separate items in the national planning strategies of ASEAN countries. Consequently, an adequate and explicit national policy position on the services sector is lacking in many ASEAN countries.

A notable characteristic of the services sector is that it is dominated by the advanced industrialized countries. Evidence suggests that this dominance is due to competitive advantages, deriving particularly from highly skilled manpower and sophisticated technologies. In many areas, advanced countries have had a head start, while developing countries are still engaged in the learning process.

In the ASEAN countries, services are quite underdeveloped, although they contribute as much as 35 per cent of the gross domestic product (GDP) of ASEAN as a whole. In the ASEAN countries excluding Singapore, during the last two decades, priority focus has been on primary-commodity and basic manufacturing industries. Like many other developing countries, ASEAN countries (excluding Singapore), are not importers of services. Their ratios of service imports to merchandise imports are larger than their ratios of services exports to merchandise exports. These ratios directly indicate their dependence on foreign governments and on transnational corporations (TNCs) for their services needs, and also directly point out the potential for import substitution in services.

The demand for services is really a demand for intangibles, either for consumption or for immediate use. Since services are used mostly at the location of the consumer, their supply inevitably has to follow the market through establishment. For that reason, in recent years, ASEAN countries have become new markets for foreign investment in those kinds of economic activities.

This paper will address four major issues related to trade in services. Section I provides a brief account of the role of services in the Malaysian economy. Section II analyses the market structure and competitiveness of Malaysia's medical services, and construction and engineering services. Section III examines the regulatory and non-regulatory barriers to the export of services. Section IV identifies some

possible means for increasing the competitiveness of Malaysia's professional services and their share of the international market. Section V concludes.

The paper has relied on two major sources of information. First, secondary research including extraction and compilation of statistical data from published as well as unpublished sources has been undertaken in an attempt to collect information on the selected services. Empirical data was also obtained from the Department of Statistics, Malaysia. Second, in-depth discussions and interviews were carried out with Chief Executive Officers and professionals in the relevant service sectors and related organizations.

The two sectors examined in detail in this paper are among the most rapidly growing service sectors in Malaysia. The construction sector has shown rapid expansion, spurred on by the rapid implementation of large public projects as well as the increasing demand for property and houses. The contributions of the engineering and construction sector are now acknowledged as critical to the Government's aspirations, particularly on the implementation of the Industrial Master Plan and for attaining the status of Newly Industrialized Countries. Opportunities for private health care in Malaysia are also growing due to the increasing demand for alternatives to government facilities. The medical industry is a major profitable industry in Malaysia. The industry currently registers between 20 and 25 per cent growth. This growth will be sustained further as the per capita income rises. In fact, Malaysia has the potential to serve the entire ASEAN region in the near future. People are more conscious of the high standards and professional capabilities of doctors and other medical staff in Malaysia.

I. THE ROLE OF SERVICES IN THE MALAYSIAN ECONOMY

Trade in services has become an important focal point of policy-making in Malaysia after the Uruguay Round of multilateral trade negotiations was launched in Punta del Este in 1986. This is hardly surprising, considering the increasing importance and growing contribution of the services sector towards the country's overall eco-

nomic growth and restructuring process. Moreover, the country's balance of payments has reached a stage where the deficit in the services account has continued to widen, with factor payments abroad constituting the biggest net outflow.

The year 1989 was the fourth consecutive year of growth in the Malaysian economy. Growth in real GDP rose at an annual rate of 8.5 per cent, close to matching the 8.7 per cent outturn in 1988. Overall, prospects are favourable for real GDP to expand beyond 8 per cent in 1990. The recent oil price rise, because of the Middle East conflict has also boosted GDP growth potential in Malaysia. In terms of nominal gross national product (GNP), growth slackened somewhat from 14.8 per cent in 1988 to 12.6 per cent in 1989, consistent with marginal lower growth in economic activity and less buoyant prices for some of Malaysia's traditional non-oil commodity exports.

Despite its moderation in growth, the major impetus to growth continues to come from the manufacturing sector which is the fastest growing sector in the economy, accounting for 25.2 per cent of GDP in 1989. Nonetheless, with total value added of the service sector estimated at $29,733 million in 1989, the growth of the service sector has also contributed to Malaysia's economic development. In line with the rapid expansion in economic activity in key sectors of the economy, the services sector registered growth of 7.9 per cent during the year (7.1 per cent in 1988) and contributed 41.7 per cent to the growth of Gross Domestic Product (GDP) in 1989. (See table 1.)

With the exception of the government services and other services sub-sectors, all other sub-sectors grew by rates substantially higher than the overall GDP growth of 8.5 per cent. However, with a more moderate growth of 4 per cent in the government services subsector, which was the largest component of the services sector, the overall growth of the sector was dampened somewhat to 7.9 per cent. (See table 2.)

Malaysia's large merchandise trade surpluses have traditionally been offset by service deficits, leading on many occasions to a chronic deficit in the current account. These deficits widened during the global recession of 1981-82 when the merchandise trade account deteriorated. The current account has been in deficit since 1980. The weak position

of Malaysia's overall trade balance services results from its unbalanced sectoral development.

Concomitant with the sharp rise in merchandise trade, higher payments for freight and insurance were incurred. At the same time, the more buoyant performance of the domestic economy in general, and of the corporate sector in particular, together with a higher foreign content of investment in the country, contributed to larger outflows in the form of investment-income payments abroad. These developments resulted in a higher services-account deficit of about M$11.1 billion in 1989, from M$10.3 billion in 1988.

The combination of a much smaller merchandise surplus and a higher services deficit led to a reversal in the current account position, from a surplus of M$4.7 billion (or 5.5 per cent of GNP) in 1988 to a deficit of M$0.4 billion (or -0.4 per cent of GNP) in 1989. However, the emergence of the deficit was not necessarily adverse, as the underlying sharp increase in imports of machinery and equipment served to expand the productive capacity of the economy.

The payments for services as a ratio of total imports of goods and services fell to 27.5 per cent in 1989 from 35.1 per cent in 1985, as government efforts to address the deficit taken since 1981 achieved some measure of success in a few areas. Policies geared towards the promotion of tourism resulted in higher receipts for travel, while more domestic education institutions through twinning programmes led to lower interest payments and a moderation in education payments abroad. Measures to promote tourism also led to higher passenger receipts by the national airline, while continued improvements to port facilities resulted in significantly higher revenue from bunder operations, port charges and disbursements. These improvements, however, were outpaced by increases in freight and insurance payments, the repatriation of profits and dividends resulting from large direct foreign investments and expenditure for overseas leisure travel.

Growth in employment in the services sector was maintained at the 1988 level of 3 per cent bringing the sector's share of total employment to 45.5 per cent or 2.9 million persons. (See table 3.) Within the services sector, the wholesale and retail trades, hotels and restaurants registered the highest job absorption at an annual rate of 5.1 per cent,

with the increase in employment opportunities being created by higher consumer spending as a result of higher income levels in 1988 and 1989.

A. Malaysia and the Uruguay Round

Trade in services is important to the developing countries, including Malaysia, but the possibility of multilateral negotiations to develop rules to govern that trade must be considered cautiously. Moreover, the increasing significance of international trade in services warrants a close look at this issue, especially in relation to whether the existing GATT rules designed for trade in goods can be suitably applied to trade in services. Trade in services is a new issue in the Uruguay Round negotiations and it is not likely that a satisfactory outcome of the negotiations on the multilateral framework of trade in services will be difficult to achieve.

It is clear that trade in services is not solely an important issue of the developed countries, but for the developing countries and the newly industrializing economies as well. Not only has the services sector come to constitute a considerable portion of domestic trade and international trade, but the developing countries have uneven sectoral interests in its liberalization, where they may acquire international competitiveness in an era of liberalization.

The position of Malaysia and the other ASEAN countries is that services trade should be part of the multilateral trade dialogue, reflecting the growing volume of transactions in this area. But, as a matter of negotiating strategy, they want the services trade to be separated from traditional merchandise trade, to ensure that no asymmetry in negotiating power exists between ASEAN and the advanced countries, which have distinct comparative advantages.

Although the domestic services sector is expanding rapidly, it is still at a rudimentary stage. For this reason, there is still the need for government protection and control on the basis of the infant-industry argument and for development or social considerations. Evidently, Malaysia is small, open and still developing . All these factors have put Malaysia in a vulnerable position in the multilateral trade negotiations.

As many developing countries need time to create and develop the services sector, Malaysia and the other ASEAN countries have developed *ad hoc* protectionist measures, which in many cases either have created monopolistic markets for domestic investors or have totally excluded foreign participation. In Malaysia, for instance, government policies are used in order to protect the growth of the Malaysian shipping industry. At least six policy measures are used for assisting the industry. Besides tax relief and other financial incentives, the Government also regulates bilateral shipping agreements. Similarly, protection is given to the national airline by granting it the sole right to handle cargo and by limiting the landing rights of other airlines.

In the case of the Malaysian insurance industry, a "freer" market existed prior to 1975. Since the Insurance (Amendment) Act of 1975, the industry is tightly regulated, which has caused the decline of foreign direct investment in that industry. Indeed, subsequent amendments to the act restrict the business role of foreign-controlled insurance companies, and new foreign investment has been prohibited. Existing foreign-controlled companies need to divest by restructuring under the directives of the New Economic Policy.

The banking industry is also tightly regulated with respect to the role of foreign direct investment. Existing foreign-controlled banks are restricted in their business expansion. Foreign investment is encouraged in certain areas, especially if it conforms to the local-ownership programme, through various kinds of joint ventures. Of late, the Malaysian Government has introduced some degree of privatization in the services sector that allows foreign investment participation. This includes the stockbroking business and dealing in commodity-futures. Again, foreign investment is encouraged to follow the broad guidelines of the New Economic Policy.

In short, Malaysia's view is that any commitment to multilateral trade negotiations must take into account the national development aspirations and socio-economic priorities. Furthermore, it would appear that Malaysia's participation in the Uruguay Round so far has been what it sees as a practical compromise between the imperatives of trade liberalization and those of development. All things considered, it seems unlikely that Malaysia and the other ASEAN countries will

completely deregulate their service sectors. At least, the ASEAN countries, excluding Singapore, feel that the economic sector should not escape their control.

II. MARKET STRUCTURE AND COMPETITIVENESS

When discussing trade in services, it is necessary to take account of the peculiarities of market structure and the competitiveness of the local firms in different service sectors. One would also need to consider the comparative advantages of local firms as well as foreign enterprises to determine their competitiveness in the individual sectors concerned.

One of the critical elements that determines comparative advantage in services is information. It is quite evident that the endowment of physical resources does not appear to be the most significant element in determining trade flows in services, and particularly in the most dynamic activities withinservices trade.

The statistics for measuring trade in services and for estimating the overall size of the markets are extremely inadequate. Different approaches are used to measure trade, from the point of view of market operators. The difficulties in measuring inter-firm transactions and the tendency of firms to offer a package of services further complicate efforts to estimate the overall size of service markets and to identify the volume and direction of trade flows.

In this section, I shall discuss the market structure and competitiveness of the two service sectors concerned - i.e. construction and engineering services, and medical services.

A. Construction and engineering services

For the purpose of this paper, we will disaggregate this sector into the following two main groups of services: (a) construction; and (b) engineering consultancy.

1. Definition

Construction services are those required for the physical construction of investment projects, be they of the infrastructural, industrial or agricultural type. By construction is meant "new construction, alteration, repair and demolition".[1] Construction services bring together labour, materials and equipment in order to translate the techno-economic specifications produced by the engineering services into concrete physical entities.

The scope and extent of the engineering consultancy services required on any project can be extremely varied. Some of the main services provided are: (a) pre-investment services, (b) advisory services, and (c) engineering services. Post-investment services comprise pre-feasibility and feasibility studies when services other than engineering servjces from a large part of the services offered. When the main characteristics of a project have been decided upon, engineering services become dominant. Engineering design here will include the preparation of design calculations, detailed plans, specifications and contract documents for tendering and construction. In addition, engineering consultancy comprises services rendered in relation to the co-ordination, control and supervision of project execution, and to the operation and maintenance of productive installation.

It should be noted here that the categorization of this sector into two subsectors, namely construction and engineering consultancy, is by no means universally used. There is a continuous interaction among the services provided by the two subsectors reflecting their interdependence. Moreover, most of the principal firms in the sector provide package services of construction and engineering consultancy. As such, the demarcation between these two subsectors is not always clear.

1 Malaysia Industrial Classification 1972, updated 1979.

2. *The role of construction and engineering consultancy services in the economy*

The Malaysian construction sector, spurred on by the rapid implementation of several large civil engineering projects and boosted by the sharp increase in domestic residential construction activities, is set to enter another boom. Following the country's strong economic performance as well as the sharp increase in investment and the recovery in domestic demand, the construction sector is expected to continue growing at a robust rate this year. The growth of the sector accelerated from 2.7 per cent in 1988 to 9 per cent in 1989, and it contributed 3.6 per cent to GDP growth in 1989. The considerable growth in the construction sector were also reflected by substantial increases in the production and sales of construction-related products during the first seven months of 1989.

In effect, the construction sector will experience a rapid growth similar to that in the late 1970s and early 1980s, when the annual growth rate reached double digits. The hypothesis is that the share of the construction and construction-related sectors as a proportion of GDP will rise gradually for developing economies, and rapidly for newly industrializing countries. This is due to the fact that as a country develops, it requires disproportionately large investments in the construction sector in order to to build infrastructural projects, roads, buildings and houses.

The upturn in the construction of private residential houses has been primarily due to the robust growth in the economy and to the sharp increase in investments. These, together with the prevalence of more realistically and affordably-priced housing units, attractive end-financing packages offered by financial institutions and the lower cost of borrowing were the major factors that facilitated the recovery in demand for houses.

A survey of housing by the Central Bank, covering 13 major towns in Peninsular Malaysia, showed a sharp increase in terms of floor area of 36.2 per cent in housing starts in 1989 in comparison to 12.8 per cent in 1988.

Another survey by the Central Bank on the construction of office space and condominiums in and around Kuala Lumpur showed that the market showed remarkable improvement in 1989. Condominiums priced below M$100,000 per unit with good location continued to be in demand, reflecting the changing life-style, especially of young professionals. The influx of expatriate businessman also led to an increased demand for higher-cost condominiums. The construction of non-residential buildings remained rather low, mainly on account of sluggish construction of office buildings. However, there was a significant pick-up in the construction of industrial buildings, resulting from the surge in investment in the manufacturing sector. Public construction activities also increased markedly with the rapid progress in the implementation of several large public projects as the Fifth Malaysian Plan draws to an end by 1990 - i.e. the National Rural Water Supply Scheme, construction of the New Klang Valley Expressway and the North-South Highway Project.

In light of the improved demand for both residential and non-residential properties, the total volume of property transactions in Malaysia rose by 22.1 per cent to 135,704 transactions, while the value of these transactions rose by 38.9 per cent to M$1.3 billion in 1989. Following the removal of restrictions on foreign ownership of property since January 1987, there has been increased foreign interest in domestic properties. Several commercial and industrial properties have been purchased by foreigners, mainly from Singapore, Japan, Hong Kong and Indonesia.

The Central Bank has introduced guidelines to ensure that non-residents do not rely solely on local funds to finance their purchase of local properties. Under the guidelines issued in March 1989 on credit facilities for financing the purchase of immovable property, non-residents or non-resident controlled companies (NRCCs) who intend to acquire immovable propeprty in Malaysia are required to bring in funds from abroad to finance the purchase. However, if any non-resident or NRCC is unable to bring in sufficient funds, they are required to apply to the Controller of Foreign Exchange for approval in order to finance the purchase from domestic sources. Such financing would be permitted for up to a maximum of 50 per cent of the purchase consideration. In addition, any borrowing in Malaysia should be repaid

within a period of three years or such further periods as may be permitted by the Controller of Foreign Exchange.

In terms of employment, the construction sector registered the fastest rate of growth, at 7 per cent per annum. This was due mainly to the construction activities which took place during the earlier part of this period, resulting from large public investments in physical infrastructure as well as private construction projects. A total of 108,500 new jobs were created, the majority of which were of site workers. Employment in the construction sector increased by 6 per cent in 1989 to 377,800 persons, accounting for 6 per cent of total employment. The average daily wages of skilled, semi-skilled and unskilled workers also increased by 7.1 per cent, 11.1 per cent and 4.2 per cent respectively.

(a) Consulting and engineering services

Generally, consulting and engineering services have grown and prospered with the country's progress and development. Indeed, there has been a symbiotic relationship between the country's drive for development and the growth in the skills and capabilities in the consulting industry. According to the Department of Statistics, the construction industry had, during the last decade or so, undergone tremendous growth at the average rate of some 25 to 30 per cent annually. At the same time, consulting and engineering services also registered increasing growth. The Government realized the important role played by the construction industry in stimulating economic growth, and was quick to take necessary measures to encourage and help the orderly growth of consulting and engineering services, which in turn provide the essential professional support services to the thriving construction industry. A major development in the growth of consulting engineers took place in the late 1960s with the passage of the Registration of Engineers Act, 1967. The Act ensured that only properly qualified persons would be allowed to carry out business as consulting engineers. Under Section 7A of the Registration of Engineers (Amendment) Act, 1987, all professional engineers practising as consulting engineers under a corporate set-up are required to register with the Board of Engineers, Malaysia (BEM) and to obtain a permit to practice.

3. The market structure

(a) Construction

The principal statistics of the large establishments in the construction industry during the years 1981-1987 (the latest year for which statistics are available from the Department of Statistics) are shown in table 4. This table indicates the main trands in the principal statistics of this industry in the recent past. The data is based on a survey of 4,595 large construction establishments conducted by the Department of Statistics, Malaysia, reporting a value of work done of at least $100,000 in 1987.

In 1987, there was a total of 4,595 construction establishments which accounted for about $5,915 million of the gross value of output and an employment of about 195,632 persons. The value added of this industry was $2,288 million in 1987. The average salaries and wages paid which had been increasing since 1981 declined in 1987. The average salaries and wages paid were $6,803 per worker in 1987, in comparison to $7,049 per worker in 1986.

The general construction industry is divided into four categories: residential construction; non-residential construction; civil engineering construction; and special trade construction.

Civil engineering construction accounted for the largest share of the gross value of output in 1987. It accounted for 38 per cent of the gross value of output, 40 per cent of the total value added and 31 per cent of the employment of the sector in 1987 as shown in table 5. The largest number of operating establishments were also in civil engineering construction which accounted for 32 per cent of the total 4,595 operating establishments. Special trade contractors accounted for the second largest number of operating establishments. These contractors accounted for about 29 per cent of the total number of operating establishments but only for about 20 per cent of the gross value of the output of the total industry.

The construction industry is mainly concentrated in the urban areas. Wilayah Persekutuan (Kuala Lumpur) is the state in Malaysia which ranked highest in construction activity in 1987. Wilayah Persekutuan (Kuala Lumpur) alone accounted for about 22 per cent of the gross value of output, 20 per cent of the value added and 16 per cent of the total employment of the industry. This reflects the concentrated urban development in the Klang Valley industrial-urban corridor. The other states where construction activity was also significant were Selangor Darul Ehsan, Johor Darul Takzim, Sabah and Sarawak. These four states, together with Wilayah Persekutuan (Kuala Lumpur), accounted for approximately 66 per cent of the gross value of output, 65 per cent of the value added and 63 per cent of the total employment of the industry.

Based on the legal status of construction firms, they can be categorized into four types: individual proprietorship; Partnership; Private limited company; and Public limited company. Table 6 shows that private limited companies accounted for the largest number of operating establishments, gross value of output and employment of the sector in 1987. The 1,941 private limited companies accounted for $4,213 million of the gross value of output and for the employment of 121,563 persons of the industry. Public limited companies appear not to have contributed significantly to the sector, either in terms of gross value of output ($358 million) or total employment (5,898 persons).

As illustrated in table 7, of the total 4,595 construction establishments operating in 1987, the majority that is 4,595 establihments or 99 per cent - were owned by Malaysians. It is of interest to note that while these 4,595 establishments accounted for 91 per cent of the gross value of output of the industry, the average gross value of output per establishment was only about $1,181,000 for these Malaysian-owned establishments as compared to $11,654,000 for the non-Malaysian-owned establishments and $5,678,000 for establishments jointly owned by Malaysian and non-Malaysian residents. About 21 per cent or 980 of the establishments employed at least 50 workers each, and these establishments accounted for 65 per cent of the gross value of output and 67 per cent of the value added of the industry. In terms of employment in the construction industry, 65 per cent of the total employment was accounted for by these groups. (See table 8.) It is also of interest to

note that on average the annual salary paid to the following categories of workers was as follows in the year 1987:[2]

Professional	M$30,000
Technical and Supervisory	M$12,000
Other Directly Employed Workers:	
Skilled	M$9,000
Semi-skilled	M$5,000
Unskilled	M$4,000
Workers Employed through Labour Contractors:	
Skilled	M$9,000
Semi-skilled	M$6,000
Unskilled	M$4,000

Athough up-to-date statistics on the sector are not available, it can be safely said that the patterns for the past five years still hold true. There has not been any dramatic change in the market structure of the sector.

(b) Engineering consultancy

The rapid development in the country, especially during the last fifteen years, has resulted in the emergence of a sizable number of indigenous engineering consultancy firms capable of offering professional engineering services comparable to some of those in developed countries. Their strength lies especially in urban and rural engineering projects as well as in promotional projects. These engineering consultancy firms are mainly concentrated in the urban areas, particularly in the capital city. Majority of the firms are private limited companies. However, there are several giant corporations which are public listed companies.

The rapid implementation of several large public investment projects by the various government agencies, ministries, public enterprises and development corporations form the principal sources of de-

2 Malaysian Department of Statistics, Industrial Survey: Construction, Manufacturing, Mining and Stone Quarrying, 1987.

mand for engineering consultancy services. Other domestic sources of demand are the private sectors such as industrial firms, financial institutions, small and medium-size enterprises and other private corporations. There is also demand from countries such as Indonesia, Nigeria, Brunei, Western Samoa, Sri Lanka, Thailand, the Maldives Islands, Fiji and New Guinea. But this has been on a limited scale so far.

The supply of engineering consultancy services in Malaysia comes from independent engineering consultancy firms, in-house government agencies or expatriate consultants engaged for specific projects. The independent construction and engineering firms operating in Malaysia supply the bulk of the construction and engineering services to meet the demand from both public and private sources.

There are 49 firms registered with the Association of Consulting Engineers Malaysia, offering services in civil, structural, mechanical, electrical, mining, chemical and oil foundation engineering. The firms range in employment from one to over 250 professional staff. Most of the firms have employment of less than 50, while only a few large firms employ more than 70 professional staff.

Most of the large firms are responsible for the large public projects. The privatization of specific projects such as the North-South Expressway and the Telecommunication Department, have resulted probably in the shift of the demand of engineering consultancy services to the private sector. Smaller firms in the industry cater mainly to small and medium-scale enterprises in the manufacturing industry and in property development. Only the Public Work Department and the Drainage and Irrigation Department have the adequate and steady flow of new investment projects necessary to maintain an in-house engineering consultancy department. The engineering consultancy projects of the two Departments are usually not very large and as such most of the projects are contracted to independent engineering consultancy firms.

The employment of foreign consultants is now highly regulated and in most cases, services of foreigners are only used when local expertise is lacking in a specific field. The supply of aids and grants from developed countries has resulted, however, in the relaxation of regu-

lations regarding the employment of foreign consultants. The privatization of the North-South Expressway, which shifted the control of employment of engineering consultancy firms to the private sector, has relaxed further the entry of foreign consultants into the market. Those trends, however, have caused some concern among engineers in domestic, independent engineering consultancy firms.

4. Analysis of the market

(a) Demand for construction and engineering services

An important characteristic of the demand for construction and engineering consultancy services in Malaysia, as in other developing countries, is its fluctuating nature, determined by fluctucations in the economy as a whole. For instance, during the recent economic recession experienced by Malaysia the demand for construction and engineering consultancy services decreased so drastically that many construction and engineering services firms were forced to reduce staff and the number of working days, accompanied by reduction in salaries. However, the current robust rate of progress in the economy and the strengthening in the domestic demand for public sector projects have led to a high demand for construction and engineering consultancy services. Steps need to be taken to make the demand for construction and engineering services more even, through co-ordinated investment by various government agencies.

(b) Ease of entry

Market entry into the construction and engineering services sector varies in terms of the nature and the degree of complexity of the projects undertaken. For instance, construction and engineering projects that require huge capital expenditure and high levels of technology, skills and expertise are usually undertaken by large firms that have been classified by the government as "class A" contractors. In this

market segment, entry is difficult. Among the obstacles to entry are the advanced engineering technology required, the huge capital expenditure involved, and the advanced level of engineering skills and expertise needed for the construction of large-scale civil engineering and high-rise building projects. These are often not accessible to medium and smaller-sized engineering firms. This market segment is therefore dominated by a few giant construction and engineering firms of which the top four well-known ones in Malaysia are United Engineers Malaysia, Pilecon, Yeoh Tiong Lay and IJM.

(c) Competition

There is an inverse relationship between the degree of competition and the value of engineering and construction projects, i.e. the higher the value, the lower the degree of competition and vice versa. While this is generally true, competition is more intense for some firms than for others. This is because the market for construction and engineering services is segmented not only along value terms but also along ethnic lines.

In an attempt to increase the participation of indigeneous Malaysians or Bumiputeras in commerce, industry and other professions, the Government of Malaysia grants a large proportion of the construction and civil engineering contracts to Bumiputera firms even if their bid price is higher than that of non-Bumiputera firms. With such segmentation of the market along ethnic lines, the competition in the market for lower value construction and engineering services is largely between Bumiputera firms, thereby restricting competition. Non-Bumiputera firms compete for sub-contracts from the successful Bumiputera contractors.

In the market for high-value construction and engineering services, there are several aspects of competition that need to be taken into account. Firstly, there exists competition between local and foreign firms in the field of advanced engineering such as bridge construction. Often, foreign firms have an edge here because of their technological superiority. For example, the contract to construct the M$1.3 billion Penang bridge, which is reported to be the longest in Asia and the

third-longest in the world, was awarded to Hyundai Engineering from the Republic of Korea because none of the local engineering firms had the required engineering expertise and technology, although one of them was selected as the local consultant. Several other giant construction projects have also been awarded to foreigners on this count. Secondly, competition can at times be stifled through the granting of civil engineering contracts to firms from countries which provide the aid to finance these projects. This is a clear case of tied-aid. For example, Biwater PLC from the United Kingdom was granted the contract to execute the engineering design for a massive rural water supply scheme, along with a local public listed company.

(d) Export of services

The above difficulties encountered by the domestic firms, together with the desire to seek foreign markets as a part of market diversification, have led several large construction and civil engineering companies to cross national boundaries to export their services. But the bulk, if not whole, of the export markets are located in the Asia-Pacific region. For example, Pernas Construction Sdn Bhd, one of the major construction companies in Malaysia, has been undertaking construction jobs in the Maldives. Another company, Pelicon Engineering group, has successfully penetrated into the Hong Kong, Singapore, Thailand and Brunei markets. At the same time, it has also identified Indonesia as yet another target market for its expansion programme overseas. The company is also thinking of expanding its operations to Vietnam, the Philippines and Australia by setting up representative offices in order to follow the business developments in these countries. Another leading local construction company, YTL, has tied up with the largest construction company in China to exploit the vast housing market there. The same company is also involved in housing projects in Papua New Guinea, Seychelles and other island nations in the Indian Ocean.

From our brief description above, it is clear that there is a clear geographical pattern as to the direction of export of Malaysia's construction and engineering services, i.e. almost all such services are exported to countries in the Asia-Pacific region. Several reasons account

for this geographical bias in the direction of the exports of construction and civil engineering services. The first is geographical proximity. The second is the availability of market information, particularly with regard to the availability of job opportunities. The third is that of the compatibility of the engineering systems adopted here and in most countries in Asia and the Pacific, and the fourth is familiarity with the cultures and values of the trading partners in the region, for example, the ethnic-cultural ties with China.

The export of construction and engineering services has also been stimulated by the Government's fiscal measures. Currently, the Government imposes income tax on only 50 per cent of the income earned from overseas construction projects and remitted to Malaysia. The other 50 per cent will be exempted from income and development tax. Any dividends issued by the company out of this is tax-exempt for shareholders. However, this exemption is valid only until 1993 and only to projects whose income is remitted within five years from the start of the project.

Malaysian expertise in construction and engineering consultancy has reached a level where it can be exported with confidence, but it requires the assistance from every available source to break into foreign markets. It is important that the Government should consider this as a priority measure. In fact, lessons should be drawn from the Korean experience of export expansion in developing Malaysia's external trade in construction and engineering consultancy services.

The advantages which could be gained from technical services export are multifold. They include:

- building a market network;
- transfer of technology;
- development of a global-market perspective;
- foreign-exchange earnings; and
- relieving pressure from the local market.

B. Medical services

1. *Definition*

In this paper, we will define public-sector medical services as services provided by the Government, while services provided by the private sector include services provided by a single person as well as by group practices, private maternity and nursing homes, and private hospitals.

2. *The role of medical services in the economy*

On the whole, health indices reveal a significant improvement in the state of health care in Malaysia since the country became independent in 1957. Malaysia enjoys a state of health superior to other developing countries in the region. However, there still exists a considerable gap between the status of health in Malaysia and that in some of the more developed countries. The infant and toddler mortality rates and maternal mortality rate has declined. The low incidence of communicable diseases such as malaria, tuberculosis and diseases of early infancy also attests to the general effectiveness of the country's health and medical programmes.

Medical services in Malaysia are, to a very high degree, capital-intensive. In 1987, the total budget of the Ministry of Health was \$1174.8 million, of which \$1081.7 million (92 per cent) was for operating expenditure and \$93 million (8 per cent) for development expenditure. In 1987, the medical sector contributed 4.29 per cent to the National Budget and 1.56 per cent to GNP. The growth of doctors in both the private and public sectors has been remarkable. In 1988, there was a total of 6043 medical practitioners, issued with Annual Practising Certificates (APC), of which 46.5 per cent were in the pubic sector and 53.5 per cent were in the private sector. Between 1975 and 1980, the number of private doctors lagged slightly behind the public doctors, although from 1985 to 1988 there were more doctors in the private sector.

3. The market structure

A striking feature of the market for medical services in Malaysia is the rigid separation between the public sector and the private sector. Even now, government hospitals are referred to as "company hospitals", intended for government servants and extending their services to the general public, whilst physicians from the private sector are not allowed to practise or use the facilities of State hospitals. This is remnant of colonial traditions, and has been a strait jacket on the development of medical services. There is a need to reorient and restructure the prevailing systems of health care for better co-ordination between the public and the private sectors in health care development. It is envisaged that a more equitable sharing of role and functions, as well as cost-sharing in health care between the public and the private sectors, will have to be achieved. Also, in the case of of private medical centres, they can look into the possibility of seeking listing in the Stock Exchange to tap capital.

In view of the growing per capita income, private hospitals should enjoy a significantly big share of the medical services market in Malaysia. More people are expected to turn to private hospitals with the better economic climate, as demand for medical care is highly income-elastic. Private hospitals in the country should complement government health care facilities and are not merely meant as a private health care service for the rich. In fact, some of the services rendered by the private hospitals will help reduce the waiting time for a patient to get treatment.

On the other hand, while private hospitals offer good growth potential, there is a self-limiting factor - private services are more expensive than those readily available from the Government. The growth actually depends on the state of the economy. If people can afford it, they will go for private care. But if the consumers' budget is a constraint, they will depend on government institutions.

Private hospitals are increasingly being constructed, some of them being set up as joint ventures with foreign firms. For example, Subang Jaya Medical Centre is a joint venture between the conglomerate Sime Darby and the National Medical Enterprises, Inc., based in the

United States. Joint ventures of this kind will no doubt maximize the opportunities arising from the strong Malaysian-American partnership and ensure the medical sectors continued access to specialized American health care expertise.

One of the current trends of private hospitals is to seek listing on the Kuala Lumpur Stock Exchange (KLSE). The first private hospital to be listed on the board is the Pantai Hospital. Another private medical group, Kumpulan Perubatan Johor may be the second medical group to be listed on KLSE. This clearly shows that the medical services can constitute a profitable business, with good potential. Private medical services are mainly concentrated in the urban areas where competition is becoming increasingly intense. This is mainly due to growing urban affluence and to the free or subsidized medical services provided to the rural population by government health facilities.

Facilities in terms of diversity of clinical specialities, sophistication of equipment and professionalism dictate the size and popularity of the individual private medical sector. The majority of the private hospital beds are also concentrated in the more urbanized and high-income states. This has resulted in some duplication of facilities and overconcentration of private services in the urban areas.

Another unique characteristic is that the Malaysian medical sector is monopolized by locals due to governmental regulations. Only Malaysians who have met the requirements of the Malaysian Medical Council (MMC) can set up practice in Malaysia. Foreign medical practitioners are only employed on a temporary basis, usually as a measure to overcome shortages in some specialized disciplines. However, there are some exceptional cases where the registration of foreign doctors has been approved by the Minister of Health, even though it was rejected by the MMC. The main reason for this objection was the fear that the registration of foreign doctors will lead to the commercialization of the domestic medical profession.

4. Analysis of the market

When discussing the market for medical services, we shall focus primarily on the market for curative medical services, since the provision of preventive health care services is usually the responsibility of the Government. This is so, because preventive medical services have the characteristics of a public or collective good, i.e. non-excludability and non-rivalry in consumption, which renders their provision by the private sector both difficult and unlucrative.

The market for curative medical services may in turn be subdivided into in-patient and out-patient services. The former usually requires a period of stay in a hospital with the period depending on, of course, how serious the illness is, while the latter involves medical consultancy and dispensation of drugs only. Let us first discuss the market for in-patient medical services.

(a) Supply of in-patient medical services

On the supply side, there are two major groups of hospitals, viz. the government-owned and the private hospitals. Essentially, the services provided by private hospitals are specialized services, provided mostly by specialists, while in government hospitals such services are provided by a mix of specialists and general practitioners.

In the rural areas, where population is more scattered and where incomes are much lower, supply is often provided by rural health clinics. Both offer a wide range of services in almost all fields of specialization, although there are some small private hospitals that offer medical services in only one particular area of specialization (usually clinical services that are not jointly demanded). Needless to say, there is no product homogeneity. Instead, there is a high degree of product differentiation, with this differentiation centering mainly around product quality.

(b) Demand for in-patient medical services

One can identify two broad segments of demand in in-patient and curative medical services. The first comprises demand by the low and middle-income consumers. Government hospitals have an almost complete monopoly over this segment, given that the charges for their services are comparatively low. The other market segment comprises rich consumers. This category of consumers has a choice between government-provided medical services and those provided by private hospitals. Those who can afford it often demand services provided by private hospitals, on account of the generally superior product offered by the latter, though among private hospitals they have a range of substitution possibilities.

(c) Supply of out-patient medical services

For out-patient curative medical services, the market is segmented along product, income and regional lines. In the most urbanized centres, the market is divided into two sub-sectors on the basis of the nature of the product, viz. the market for general non-specialized services and the market for the services of specialists.

In the market for general non-specialized services, the suppliers are:

- Government-owned out-patient clinics, some of which are independent and some others attached to government hospitals; and

- Privately-run clinics most of which are sole proprietorships, with some partnerships.

(d) Demand for out-patient medical services

Again the poor in the urban centres, whose employers do not provide free medical treatment to them, generally turn to the government-run clinics, while the rest of the consumers patronize private-run clinics.

(e) Pricing policy

Despite the Government having a monopoly over the industry, there is no fear of any predatory fleecing of consumers through the charging of high prices. This is due to the fact that the supplier, which is the Government, has as major social objective - i.e. the low-cost provision of health services. Traditional fears over monopolistic pricing clearly do not apply here, since the Government does not have the private-sector corporate objective of profit maximization. The pricing policy of government-owned hospitals is that of price discrimination, where patients are classified into three broad socio-economic categories according their income levels and then charged appropriately, with first-class having to pay considerably more than the second-class patients, who in turn have to pay more than the third-class patients.

But relative to the corresponding charges of private hospitals which also practise price discrimination, government levies are usually much lower. A substantial proportion of the first and second-class patients at government hospitals comprise government servants. One of the incentives provided to government servants is free medical treatment at government hospitals.

By insisting that government servants get free treatment, provided that they obtained the services from government hospitals only, the Government has created a captive market for its own medical services.

(f) Competition

While private hospitals are in some ways better than government hospitals, thereby having a competitive edge over them, the competition among the private hospitals for in-patient clinical services has become more intense. This is, of course, particularly true in big city centres such as Kuala Lumpur and Penang where there are several oligopolistic hospital enterprises. The competition between them is keener since there is much less product differentiation among them than that exists between them and the government hospitals.

The competition is therefore not so much between government and private hospitals as among private hospitals. But this is not true all the time. During times of recession, the competition between government and private hospitals becomes keener since demand for luxurious goods, including private medical treatment, tends to be highly income-elastic. In the urban centres, competition among private clinics has become increasingly intense, especially with the rapid growth in the number of such clinics.

With the mushrooming of private hospitals in the country, public hospitals face keen competition. In view of competition from the local private sector as well as overseas, the question of brain drain in the public sector poses a great problem of concern for the Government. Brain drain has taken three forms:

- Resignation of doctors into the private sector;
- The migration of doctors from the country; and
- Doctors who have resigned being replaced by less experienced ones.

The increasing outflow of public medical officers and specialists to the private sector and overseas are due to the better prospects and incentives offered by the private sector.

(g) Export of Medical Services

In the medical sector in Malaysia, there is virtually no export of medical services. In the ASEAN region, practically the entire export market has been captured by Singapore which has a good reputation for providing technically superior products. Besides, Malaysia's private hospitals do not as yet have sufficient capacity to cater to the export market. The domestic market size during good times is big enough to ensure full use of capacity the of Malaysia's private hospitals. Lack of adequate information on Malaysia's range of medical services is another factor contributing to the virtual non-existence of the export market. But the crucial factor is still the perceived relative inferiority of

Malaysia's medical services, particularly when compared to those supplied by Singapore.

The export of medical services are also constrained by regulatory requirements discussed later in this paper. However, factors such as historical ties, geographical proximity and cultural aspects no doubt influence the pattern of export.

While the export market is virtually non-existent, there are imports of medical services from abroad. This involves the temporary movement of patients from Malaysia to neighbouring Singapore and sometimes even to the United States and United Kingdom in order to seek better quality products. Such imports will probably grow with growth in income, and with the possible deterioration in medical standards in Malaysia.

Singapore is the major source of imports of medical services into Malaysia on account of its geographical proximity which renders transport costs much lower. Besides, there are close cultural affinities between Singapore and Malaysia, especially among the Chinese components of the two populations. The prices of Singapore medical services are also relatively cheap. For instance, many Malaysians who can afford specialist treatment seek medical care at the Mount Elizabeth Hospital Ltd., one of the specialist centres in Singapore with a reputation for high-quality health care. Moreover, the comfortable facilities and services add value to the quality of the medical services.

(h) Competitiveness

Competitiveness is in turn determined by the level of technology which encompasses the use of knowledge, experience and capital equipment. From the point of view of know-how and experience, the quality of medical services provided by private hospitals is perceived to be higher, as the doctors in private hospitals are usually well-qualified and more experienced than their counterparts in government hospitals. This is, of course, the most important determinant of competitiveness, which is in the form of product quality since the quality, of the services is embodied in the quality of the provider. This is not to say, however,

that all government-owned hospitals are necessarily inferior in this regard. Major government-owned hospitals, such as the General Hospital in Kuala Lumpur and the University of Malaya Teaching Hospital, still have many good and experienced specialists.

At the level of capital equipment, the other aspect of technology, major government hospitals located in city centres often have equipment of as high quality as in private hospitals. In fact, some government hospitals have more modern and advanced equipment than private hospitals. This is because some of the equipment requires a certain intensity of use in order to be economical. Given the high costs of the equipment, its lumpy and indivisible nature and the need to be cost-conscious, private hospitals often find their level of demand for the services of such equipment to be small in relation to the level required for efficient use, and therefore find no economic justification for the purchase of advanced equipment.

The need to be more mindful of costs is much less urgent in government hospitals since they do not operate with commercial objectives. Hence, diagnosis requiring the use of advanced equipment can often be performed only in government hospitals. Nursing care, on the other hand, is vastly superior in the private hospitals compared to government hospitals while the turnaround time, i.e. time between registration and consultancy and between admission and operation, is also much shorter in private hospitals.

In short, product quality by private suppliers is generally higher on account of better technological inputs, superior consultancy and surgical services, shorter waiting time and better nursing care. Product quality is given very high importance by consumers in this sector.

(i) Human resources

There is an acute shortage of doctors in Malaysia, particularly in the specialist fields. The Ministry of Health employs foreign specialists on a temporary basis as a measure to overcome the shortage of specialists in various disciplines such as anaesthesiology, ophthalmology, radiology and psychiatry. Table 9 shows the number of specialists in the

government sector. In actual fact, this is more of a problem of unequal distribution of doctors among the rural and urban areas than shortage of doctors *per se*. The doctor/population ratio in 1987 was 1:2852 compared to 1:2986 in 1986.

There is also an unequal distribution of doctors between different states. Most of the doctors practise in the economically more advanced states. The majority of private hospital beds are concentrated in the more urbanized and high-income states such as:

Federal Territory	37.5 per cent
Selangor	16.5 per cent
Pulau Pinang	16.5 per cent
Perak	14.0 per cent

The distribution of private doctors by state also clearly indicates that the majority of these doctors serve the more developed states of Malaysia, further aggravating the situation of unequal distribution of doctors and of poor medical care in the less developed areas. The ratio government doctors to private doctors further emphasises the disparity between the states. The ratios indicate that there are more private practitioners than government doctors. (See table 10.) Current official collection of information on private hospitals is still conservatively quantitative in nature.

While the demand for medical services, especially hospital services, has been on the rise, it is evident that services have not been used equally in all hospitals. Some hospitals have clearly been underutilized. This appears to be particularly the case of the smaller, district public hospitals. Occupancy in the Government district hospitals is on the whole lower than the Government General Hospitals. Most of the small district hospitals have a low occupancy rate, while the best utilized hospitals are those with specialist facilities and those serving the larger metropolitan areas.

(j) Training

Service and training must go hand in hand in order to ensure optimum levels of practice and to remain competitive in the market. Increased awareness and demand for high technology services have resulted in greater public expectations. In view of this, the Training and Manpower Development Department of the Ministry of Health has been geared towards meeting the medical and health service requirements. In its manpower development programme, the Ministry of Health gives emphasis to the linkages between manpower development and health-service development.

Training and manpower development activities are geared towards meeting the needs of health programmes by ensuring the adequacy of staffing mix and the required competency of the health personnel. The Ministry of Health has been conducting several basic courses in various training institutions in the country. These training programmes are expected to assist in improving the competitiveness of the public sector.

Private hospitals are also expanding and modernizing their services and facilities to be on par with leading hospitals in the world. For example, Tawakal Specialist Centre is planning to undertake a $36 million expansion project to improve its performance and facilities. Strategies for the development of the medical services sector must take into account the following:

- Changing morbidity pattern;
- Escalating cost of medical services in both the public and private sectors;
- Rising public expectations;
- Serious contraints on available resources; and
- Demand for new technology.

(k) Opportunities

Opportunities for private health care in Malaysia are growing due to increasing demand for alternatives to government facilities. The medical industry is profitable in Malaysia, and currently registers an annual growth rate of 20 to 25 per cent. In fact, Malaysia has the potential to serve the entire ASEAN region in the near future. People are now more conscious of the high standards and professional capabilities of doctors and medical staff in Malaysia.

II. BARRIERS TO EXPORT OF SERVICES

This section will attempt to identify the major barriers to the export of construction, engineering design, and medical services in Malaysia. It will first examine whether there are Government-imposed rules and regulations that hamper the export capacity of these services. Non-regulatory barriers resulting from economic, political, cultural or geographical grounds will also be discussed.

A. Government-imposed rules and regulations

Export of services can involve either the movement of the service-provider across the national boundaries of the receivers or, alternatively, the movement of the receivers to the countries of the providers. However, this need not be the case in service exports that involve the electronic transmission of data.

This paper has focused on two service sectors - construction and engineering consultancy, and medical services - of which the second involves either of the two movements, while the first involves a movement of the providers to the countries of the receivers and not vice versa. In studying Government-imposed rules and regulations on the export of services, we need to differentiate between those that restrict the movement of the providers from those that restrict the movement of the receivers.

1. Restrictions on the movement of service producers

The rules and regulations imposed by the Malaysian Government against the export of professional services via the movement of Malaysian professional firms across national boundaries, include the following.

Visits by professionals to South Africa and Israel for providing services are prohibited on political grounds. This applies to visits of other nature by Malaysians as well as to the export of goods.

The movement of service producers to China, Vietnam, Laos, Kampuchea, Albania and North Korea requires the prior approval of the Ministry of Home Affairs. In this case, service producers are required to submit an application to the Ministry of Home Affairs which normally grants the approval. Although readily granted, approval to service producers for travel to these countries is usually given for a restricted period only, and the provision of consultancy services for prolonged periods may be difficult.

While there may not be that many rules and regulations imposed by the Malaysian Government on the movement of service producers, there are many imposed by the governments or the professional bodies of other countries. All service producers, from accountants and doctors to engineers, are usually required by many foreign governments to obtain a work permit or professional pass. And this will only be granted when proof can be produced that the relevant professional skills are not obtainable locally. This is often very difficult. Therefore, the difficulty in obtaining a professional pass from foreign governments to enable the providers of professional services to move to the countries of the receivers represents a major barrier to trade in professional services. This, is in turn, related to the legal requirement that has been instituted in almost all countries that preference should be given to the hiring of nationals in the provision of professional services unless, as said earlier, such skills are not available locally. Compliance with this requirement means very limited scope for the providers of professional services to move into the markets of other countries, especially of developed countries.

Another major barrier is that pertaining to the recognition of qualifications and to the related requirement that professionals such as doctors and engineers must register with the relevant professional bodies in the respective overseas countries before they are allowed to provide their services. For instance, doctors are required to have an academic degree from a recognized university, followed by a year of medical internship. If the degree is not recognized by the overseas government or by the respective medical professional bodies, then entry is denied to the service provider.

2. *Restrictions on the movement of service receivers*

With regard to movement of service receivers, the Government of Malaysia does not restrict the entry of service receivers into the country. In fact, the maintenance of an undervalued exchange rate, if this can be regarded as a side-effect of Government policy, serves to encourage exports, of both goods and services.

B. Non-regulatory barriers

Apart from Government-imposed regulations, there are other non-governmental barriers to the export of services and these apply to the movement of providers as much as to the movement of the receivers. The first among such barriers is liguistic. For Malaysia, English is still widely used as the main link language in professional services, although the national language is also increasingly used. This at once delineates the export markets for Malaysia's professional services to be mainly, though not exclusively, restricted to the English-speaking world which, however, is still large.

But the main obstacle is the perception, particularly in developed countries, that Malaysia is technologically still inferior in services. Hence Malaysia is more a net importer, with prospects for the export of medical, construction and engineering services, though there has been some breakthrough in the latter by a few giant technologically capable local construction and engineering firms have managed to export to some neighbouring countries. Pilecon, a local construction and engineering firm, has successfully developed a superior technique of piling

that has subsequently earned for itself a good reputation in the construction and engineering industry in the ASEAN region. As a result, a few major contracts have been won by the firm, both in neighbouring Thailand and in Singapore.

This shows that if local professional firms are able to develop good quality products, they can still penetrate export markets. But a reorientation in attitudes, as well as the removal of biases on the part of both developed and developing countries, is required before the prospects for the export of services from developing countries can be improved.

Finally, lack of information about opportunities for exports constitutes a major barrier to service exports. There is a need for professional bodies from different countries, especially those from developing countries, to exchange such market information so that the availability of export opportunities can then be disseminated more effectively.

III. SERVICES EXPORT COMPETITIVENESS

A. Increasing competitiveness

Increasing the competitiveness of Malaysia's medical, construction and engineering services in the international market place depends on upgrading the quality of professionals, as these services are to a large extent embodied in the providers. This includes upgrading the technological capacity, competence and therefore the productivity of the professionals. However, Malaysia's prospects in service exports can only be realized if certain fundamental changes are introduced to enhance the competitiveness of these services. Apart from investing in physical and technical inputs, an important measure is to promote the effective use of foreign languages, especially English, which is the principal medium for conducting service trade.

The Government's policy of using Malay, the national language, in education and manpower training serves the political objective of the new economic policy and national unity. However, from the point of view of training manpower for the service industries, especially if the

objective is to capture a global market share, then the use of English would be more efficacious. The use of English not only facilitates wider communication, but also assists Malaysia in accessing technical information and databank which are predominantly in English.

At the same time, in view of the scarcity of high value-added skilled professionals in the services industry, more focused strtegies in educational and manpower planning are urgently needed. In this context, the affirmative action programme of the new economic policy needs to be adjusted so that equality of access, based on merit to all Malaysians can be promoted.

A positive incentive programme to discourage emigaration of professionals could also be adopted. The outflow of professionals from Malaysia, due to the push-and-pull factor, has created critical skilled manpower bootlenecks, which has been detrimental to the growth of service industries. It is not economical to allow the emigration of skilled manpower from Malaysia as this means the loss of human capital in which much financial resources and training have already been invested.

Besides discouraging the emigartion of skilled professionals, incentive programmes also need to be devised in order to attract foreign skilled professionals to help Malaysia build up its services industries. This requires liberalizing immigration control in using foreign skilled professionals. Already, there is an extensive use of foreign unskilled labour, both legal and illegal. The policy of using foreign skilled professionals is therefore logical, and can be implemented without negative fallouts to the economy. This is equivalent to the use of technical and managerial expertise which foreign direct investors are allowed to bring into Malaysia as part of the incentive programme in the manufacturing sector.

One of the important steps that the Government should take, besides promoting technical and manpower training, is to secure international recognition of the academic standards and qualifications. This would ensure that the manpower trained in Malaysia is recognized and acceptable world-wide. This would facilitate brain swapping and exchange of expertise, training programmes and trainees at an international level.

If the Government is committed to a programme in exporting services, it has to resolve many of the problems, including socio-economic, political and bureaucratic ones, which are wide-spread obstacles in several countries. The urgency of this will definitely intensify, as pressures for global deregulation for services increase.

B. Increasing international market share

If the Government and the private sector are committed to capturing a share of the international market for services, they would need to formulate a strategic master plan which incorporates the following elements:

- A coherent policy and programme for the export of servicess;
- Targeting specific service industries that can be transformed into successful service export centres;
- Formulate and build the necessary infrastructure for the export of services, viz. communication, computer-support facilities, etc;
- Securing the necessary international recognition and acceptance of various local academic standards and qualifications;
- Close co-ordination and collaboration between the Government and the private sector to seek foreign markets through trade missions, service exhibitions and other marketing strategies;
- Developing a global-oriented corporate strategy by the private sector to tap the market;
- Developing and forging strategic alliances by Malaysian companies in the service industries with their overseas counterparts; and
- Supporting international efforts to deregulate the services sector.

IV. CONCLUSION

With sustained economic growth comes structural changes, both in terms of the industrial composition of GDP and the structure of

trade. As income continues to grow, services as a proportion of GDP will increase. This will in turn lead to those services that are tradable becoming an increasingly important component of both exports and imports. Thus the 1990s will witness an expansion in trade in services, provided that efforts at freeing international trade from barriers to trade in both goods and services become successful.

Indeed, if there is a case for free trade in goods, there must also be a case for free trade in services. After all, both are founded on the theory of comparative advantage, which argues that countries should produce those goods and services for which their opportunity costs of production are relatively lower. Based on this, world allocation of resources will be optimal, and production as well as consumption possibilities for all will be increased, with attendant increases in consumer welfare, that follow from the international exchange of goods and services.

Malaysia wishes to see a successful conclusion to the Uruguay Round. However, Malaysia, like other developing countries, is concerned over the possible dominance of trade in services by the developed countries, with dire consequences for the current accounts of developing countries' balance of payments. Their fear is founded on the belief that developed countries currently have a competitive advantage in the production and export of services, specifically non-factor services, and the component of non-factor services called transmitted information which includes financial services, business (accounting, legal, consultancy and advertising) services and information (news agency, data processing) services.

If a successful agreement on trade in services is to be reached, there should be a balanced framework of rights and obligations which offers protection to investing countries as well as to host countries. What is more important at this initial point is that the agreement should be comprehensive in scope and liberal in effect. A balanced outcome here also implies that due account should be taken of the specific interests and legitimate needs of developing countries in accordance with the Punta del Este mandate. The participation and contribution of developing countries should, where appropriate, continue to be guided by the principle of special and differential treatment and by develop-

ment considerations. As in the GATT itself, liberalization must be seen on the basis of overarching general principles.

The liberalization of market access has to be negotiated on the basis of mutual concessions with special consideration for developing countries to take measures to strengthen their domestic service capacity, efficiency and competitiveness. The multilateral framework should facilitate the negotiations on progressive liberalization of trade in services as a means to achieve the following objectives:

- To promote economic growth of all trading partners;
- To increase the pace of development of developing countries;
- To ensure equitable benefits for the developing countries at each stage of the negotiations; and
- To reduce protectionism.

In the context of the possible liberalization of service trade, Malaysia should evolve a coherent strategic programme, an appropriate regulatory framework and a targeted project for enhancing the competitiveness of domestic service firms and penetrating world markets. The services industry is both extensive and highly segmented. Malaysia would need to determine specifc market segments for special focus. This would, however, require a reorientation of traditional economic planning and export-market programming. The service sector has its own peculiar features, which are quite different from the traditional trade in commodity or manufacturing export. The production and trade of services have become highly knowledge- and information-intensive. Unlike traditional production and trade in primary commodities or even manufacturing, service trade does not depend on the presence, nor is it restricted by the absence, of natural resources. But it does depend on the quality and skills of the service providers. This means that competitive advantages in the services sector can be created since the principal input components are people and knowledge. Essential prerequisites for this include institutional infrastructures and adequate training institutions. A reorientation is also needed in the marketing and production strategies of the domestic service firms and

the private sector, who should aim at penetrating international markets and learn to operate in a more liberal competitive environment.

The conclusion that we have drawn in this paper is that while the construction and engineering industry has acquired some marginal experience at the regional market level, the medical service sector is yet to make a mark for itself in the international market. In the short and medium term, the construction and engineering industry appears to have a high potential for securing a place for itself in some market niche at the regional and subregional level.

The hard reality that the Malaysian Government and the private sector must face is the great difficulty of promoting exports in services. If trade in conventional goods is protected, it is more so in the services industry. As such, besides improving their competitiveness, Malaysian service exporters must also learn the art of penetrating protected markets. And this will not be easy.

Box 1

MALAYSIAN ECONOMY AND SERVICES

Over the past years, the Malaysian economy has shown rapid development, and many analysts regard Malaysia as the one of the fastest industrializing countries in the world. The country's per capita GDP figure has risen above $2,000, and it is the world's largest exporter of semiconductors, and one of the largest exporters of room air-conditioners.

Infrastructural development has become a major priority in Government policies recently. In 1989, Malaysia announced an 18 per cent increase in Government development expenditure, most of which will be spent on infrastructural improvements to the road, rail, and port systems. The railway is expected to be double-tracked along the industrial corridors of the Klang Valley and Rawang-Seremban, and M$450 million is to be spent on increasing capacity at Pulau Lumut and Port Klang, where demand is expected to increase by 50 per cent by 1995.

Construction services are expected to become the fastest growing area in the economy in the near future. Infrastructural development projects, upsurge in demand for new houses and factories, and the rapid appreciation of the value of commercial property in Kuala Lumpur (which doubled in 12 months) have contributed to a dramatic growth in the construction sector. Growth in the sector tripled to reach 8.5 per cent in 1989.

In the financial sector too, major changes have occurred in recent years. The splitting of the Kuala Lumpur Stock Exchange from the Stock Exchange of Singapore in 1989 marks the first major step on the part of Malaysia to reduce its outflow on services to Singapore, and may also result in more international trade in the Malaysian ringgit. Changes in the financial system are also expected to force the foreign banks in the country to tie up substantial sums in capital for their subsidiaries. It has also been specified that the foreign banks will be allowed to compete with the domestic banks on the same terms only if they sell 30 per cent of their equity to the Bumiputras. There has also been a similar programme for enforced localization in the insurance sector. After a number of bank failures and takeovers by the State, a new banking legislation has been introduced in Malaysia, which gives enhanced powers to the central bank to control the licensed financial institutions.

Source: ***Asia 1990 Yearbook*** **(Hong Kong, Review Publishing Co., 1990), pp. 174-75**

Table 1

MALAYSIA: PERCENTAGE SHARE TO GDP BY SECTOR, 1985-1988

Sector	*1985*	*1988*	*1989* [a]
Agriculture, livestock, forestry and fishing	20.8	21.1	20.2
Mining and quarrying	10.5	10.4	10.3
Manufacturing	19.7	24.4	25.6
Construction	4.8	3.2	3.3
Services	43.5	42.0	41.7
Less imputed banks services charges	3.2	4.3	4.7
Plus import duties	3.9	3.2	3.6
Total	100	100	100

Source: Ministry of Finance, Malaysia, Economic Report, 1989/90.
a Estimates.

Table 2

GROWTH IN SERVICE SECTORS IN CONSTANT 1978 PRICES

	Share of GDP in 1989	*1988*	*1989* [a]
		Change in percentage	
Electricity, gas and water	1.9	9.2	9.8
Transport, storage and communication	6.8	8.8	10.5
Wholesale and retail trade, hotels and restaurants	10.6	8.8	9.2
Finance, insurance, real estate (including ownership of dwellings) and business services	9.0	9.0	10.0
Government services [b]	11.3	3.7	4.0
Other services [c]	2.1	3.9	4.0
Services	41.7	7.1	7.9

Source: Bank Negara Malaysia, Annual report, 1989.
a Includes general public services (general public administration, external affairs, and public order and safety), defence, health, education and others.
b Includes community, social and personal services, product of private non-profit services to households and domestic services of households.
c Preliminary.

Table 3

EMPLOYMENT BY SECTORS [a], 1988 AND 1989

	1988		1989	
	Thousands	*Percentage*	*Thousands*	*Percentage*
Agriculture, forestry and fishing	1,908	31 3	1,935	30 7
Mining and quarrying	37	0 6	38	0 6
Manufacturing	1,013	16 6	1 090	17 3
Construction	357	5 9	378	6 0
Electricity, gas and water	45	0 7	46	0 7
Wholesale & retail trade, hotels and restaurants	1,070	17 6	1,125	17 9
Finance, insurance, real estate, business services	212	3 5	217	3 5
Transport, storage and communication	261	4 3	267	4 3
Government services	844	13 9	853	13 5
Other	341	5 6	349	5 5
Total	6,088	100 0	6,298	100 0
Services	2,773	45.5	2,857	45 5

Source: Economic Planning Unit.
a Estimates

Table 4

CONSTRUCTION INDUSTRIES IN MALAYSIA: PRINCIPAL STATISTICS OF CONSTRUCTION INDUSTRIES, 1981-1987

Year	No. of estab-lish-ments	Gross value of output (thousand dollars)	Cost of input (thousand dollars)	Value added (thousand dollars)	Total no. of persons engaged during December 1987 or the last pay period, 1987			Salaries and wages paid (thousand dollars)	Value of fixed assets owned at 31.12.1987 (thousand dollars)
					Total	Malaysian Citizens	Non-Malaysian Citizens		
1981	4,584	6,086,140[a]	-	-	243,603	225,596	18,007	1,353,637	992,746
1982	5,127	8,111,496[a]	-	-	282,337	259,995	22,342	1,814,947	1,311,596
1983	5,101	9,108,806	5,490,943	3,617,863	306,412	279,173	27,239	2,061,897	1,394,430
1984	5,377	9,702,165[a]	-	-	297,811	268,536	29,275	2,057,250	1,657,136
1985	5,187	9,648,075	6,026,749	3,621,326	294,065	264,553	29,512	2,068,500	1,659,006
1986	5,011	8,026,323	4,969,549	3,056,774	250,172	227,417	22,755	1,763,377	1,399,598
1987	4,595	5,914,975	3,626,309	2,288,666	195,632	179,521	16,111	1,330,808	1,232,589

Source: Malaysian Department of Statistics, Industrial Surveys: Construction, Manufacturing, Mining and Stone Quarrying, 1987.
a Refers to total revenue.

Table 5

CONSTRUCTION INDUSTRIES IN MALAYSIA: PRINCIPAL STATISTICS OF CONSTRUCTION INDUSTRIES, 1987

Industry	No. of establishments	Gross value of output (thousand dollars)	Cost of input (thousand dollars)	Value added (thousand dollars)	Total no of persons engaged during December 1987 or the last pay period, 1987			Salaries and wages paid (thousand dollars)	Value of fixed assets owned at 31 12 1987 (thousand dollars)
					Total	Malaysian Citizens	Non-Malaysian Citizens		
General construction	3,276	4 757,130	2,859,276	1 897,854	161 567	146 675	14,892	1,105 175	1,028 145
Residential construction	1,139	1,433,884	853,960	579,924	60,779	55,034	5,745	381,386	299,842
Non-residential construction	689	1,099,552	703,629	395,923	39 252	35 004	4 248	254,010	205,986
Civil engineering constrution	1,448	2 223,694	1,301,687	922,007	61,536	56 637	4,899	469 779	522,317
Special trade construction	1,319	1 157,845	767,033	390,812	34 065	32 846	1,219	225 633	204,444
Total	4,595	5,914,975	3,626,309	2,288,666	195,632	179,521	16,111	1,330 808	1,232 589

Source: Malaysian Department of Statistics, Industrial Surveys Construction, Manufacturing Mining and Stone Quarrying 1987

Table 6

CONSTRUCTION INDUSTRIES IN MALAYSIA: PRINCIPAL STATISTICS OF CONSTRUCTION INDUSTRIES BY LEGAL STATUS, 1987

Legal status	No of establishments	Gross value of output (thousand dollars)	Cost of input (thousand dollars)	Value added (thousand dollars)	Total no. of persons engaged during December 1987 or the last pay period, 1987			Salaries and wages paid (thousand dollars)	Value of fixed assets owned at 31.12.1987 (thousand dollars)
					Total	Malaysian Citizens	Non-Malaysian Citizens		
Individual proprietorship	1,710	796,086	498,440	297,646	40,950	38,375	2,575	199,259	131,090
Partnership	927	547,542	332,757	214,785	27,221	25,850	1,371	136,070	86,022
Private limited company	1,941	4,213,348	2,568,230	1,645,118	121,563	109,767	11,796	915,408	895,023
Public limited company	17	357,999	226,882	131,117	5,898	5,529	369	80,071	120,454
Total	4,595	5,914,975	3,626,309	2,288,666	195,632	179,521	16,111	1,330,808	1,232,589

Source: Malaysian Department of Statistics, Industrial Surveys: Construction, Manufacturing, Mining and Stone Quarrying, 1987.

Table 7

CONSTRUCTION INDUSTRIES IN MALAYSIA: PRINCIPAL STATISTICS OF CONSTRUCTION INDUSTRIES BY OWNERSHIP, 1987

Ownership	No. of establishments	Gross value of output (thousand dollars)	Cost of input (thousand dollars)	Value added (thousand dollars)	Total no. of persons engaged during December 1987 or the last pay period, 1987			Salaries and wages paid (thousand dollars)	Value of fixed assets owned at 31.12.1987 (thousand dollars)
					Total	Malaysian Citizens	Non-Malaysian Citizens		
Malaysian residents	4,545	5,368,133	3,282,617	2,085 516	186 252	172 128	14 124	1 224 988	1 155 678
Non-Malaysian residents	44	512 772	317 552	195 220	9 117	7,165	1 952	101 709	75 644
Joint ownership	6	34 070	26,140	7 930	263	228	35	4 111	1,267
Total	4,595	5 914 975	3,626 309	2 228,666	195 632	179 521	16 111	1 330 808	1 232,589

Source: Malaysian Department of Statistics, Industrial Surveys. Construction, Manufacturing, Mining and Stone Quarrying, 1987

Table 8

CONSTRUCTION INDUSTRIES IN MALAYSIA: PRINCIPAL STATISTICS OF CONSTRUCTION INDUSTRIES BY TOTAL EMPLOYMENT SIZE GROUP, 1987

Total employment size group	*No. of establishments*	*Gross value of output (thousand dollars)*	*Cost of input (thousand dollars)*	*Value added (thousand dollars)*	*Total no. of persons engaged during December 1987 or the last pay period, 1987*			*Salaries and wages paid (thousand dollars)*	*Value of fixed assets owned at 31.12.1987 (thousand dollars)*
					Total	*Malaysian Citizens*	*Non-Malaysian Citizens*		
Below 5	106	19,569	13,913	5,656	372	367	5	2,097	5,193
5 - 9	721	178,939	118,252	60,687	5,216	5,005	211	29,439	45,314
10 - 19	1,311	559,146	356,881	202,265	18,372	17,520	852	105,005	180,442
20 - 29	756	500,009	313,659	186,350	18,012	16,926	1,086	105,902	129,929
30 - 49	721	796,286	485,919	310,367	27,383	25,838	1,545	169,918	153,734
50 - 99	590	1,133,069	702,174	430,895	39,982	36,882	3,100	259,110	231,774
100 - 199	240	1,003,003	607,914	395,089	31,845	28,414	3,431	233,867	158,146
200 - 499	131	1,166,800	676,995	489,805	37,595	34,349	3,246	286,505	236,450
500 - 999	12	319,164	216,567	102,597	7,990	6,309	1,681	62,538	44,358
1,000 and above	7	238,990	134,035	104,955	8,865	7,911	954	76,427	47,249
Total	4,595	5,914,975	3,626,309	2,288,666	195,632	179,521	16,111	1,330,808	1,232,589

Source: Malaysian Department of Statistics, Industrial Surveys: Construction, Manufacturing, Mining and Stone Quarrying, 1987.

Table 9

MEDICAL SPECIALISTS IN GOVERNMENT SERVICE IN MALAYSIA AS ON 31 DECEMBER 1987

	Superscale posts		*Timescale posts filled*			*Total number of*
	Post	*Filled*	*Malaysian*	*Non-Malaysian*	*Total*	*specialists employed*
General physician	42	31	34	1	35	66
General surgeon/ obsterician	40	32	18	1	19	51
Gynaecologist	32	27	10	1	11	38
Anaethesiologist	31	11	6	6	12	23
Opthalmologist	27	14	2	3	5	19
Orthopaedic surgeon	14	11	6	-	6	17
Radiologist	23	13	4	1	5	18
Paediatrician	22	13	16	2	18	31
Pathologist (hospital)	17	13	2	-	2	15
Psychiatrist	12	7	1	1	2	9
TB/Chest physician	11	7	2	-	2	[illegible]
Radiotherapist/ Oncologist	6	4	1	-	1	5
Otorhinolaryngologist	8	5	3	3	6	11
Dermatologist	9	6	5	1	6	12
Urologist surgeon	4	1	2	-	2	3
Neurosurgeon	4	2	-	-	-	2
Neurologist	3	2	-	-	-	2
Nephrologist	3	1	1	-	1	2
Haemotologist	4	2	2	-	2	[illegible]
Cardio-thoracic surgeon	2	1	3	1	4	5
Plastic surgeon	3	1	6	-	6	7
Forensic pathologist	2	2	-	-	-	2
Paediatric surgeon	2	-	-	-	-	-
Cardiologist	4	2	3	-	3	5
Total	325	208	127	21	148	356

Source: Medical Services Division, Ministry of Health

Table 10

TOTAL NUMBER OF REGISTERED DOCTORS ISSUES WITH ANNUAL PRACTISING CERTIFICATE IN GOVERNMENT AND PRIVATE SECTOR, MALAYSIA, 1987

State	*Government*	*Private*	*Private (percentage)*
Perlis	27	20	42.6
Kedah	118	140	54.3
Penang	160	370	54.3
Perak	221	446	66.9
Selangor	123	556	81.9
Wilayah Persekutuan	840	706	45.7
Negeri Sembilan	109	134	55.1
Malacca	81	105	56.5
Johor	181	329	64.5
Pahang	101	118	53.9
Terengganu	95	48	33.6
Kelantan	205	67	24.6
Peninsular Malaysia	2,261	3,039	57.3
Sabah	75	150	66.7
Sarawak	127	142	52.8
Malaysia	2,463	3,331	57.5

Source: Malaysia Medical Council

TRADE IN SHIPPING SERVICES: INDIA, MALAYSIA, AND THAILAND

L.M.S. Rajwar*

INTRODUCTION

Issues related to the services sector have received increasing attention in recent years, especially in relation to the attempt to negotiate a multilateral framework on trade in services in the Uruguay Round. These negotiations have as their objective the expansion and progressive liberalization of international services trade as a means of promoting the economic growth of all trading partners and the development of developing countries. In comparison with the importance of services in the world economy, the amount of services traded internationally has been rather small. In 1980, services amounted to over 60 per cent of world GDP, but only 8 per cent of the services produced were traded internationally. Since then, the international trade in services has increased as a result of technological improvements in telecommunications and of the rapid advances in the information industry. However, several services are still produced and consumed domestically.

In contrast to many other service sectors currently being negotiated in the Uruguay Round, shipping has apparently always been an international service insofar as most of the shipping transactions have constituted international trade always. The domestic shipping trade of nations form only a very small proportion of the world shipping trade. However, from this it will be inappropriate to surmise that shipping trade has been liberal or symmetric in the provision of opportunities. In fact, there is a gross asymmetry between developed and developing countries in their ownership of fleet in relation to their participation in international seaborne trade. In 1988, developed countries accounted

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* The author is a consultant to UNCTAD.

for 56.6 per cent of the overall seaborne trade in the world, while they owned 67.8 per cent of the fleet. Developing countries, on the other hand, have a share of 35.6 per cent of the world seaborne trade, but their share in the ownership of fleet was only 20.9 per cent. The figures for socialist countries were 7.8 per cent and 10.2 per cent respectively. These figures give an indication of the asymmetries in the international shipping marketin terms of ownership of fleet. Similar imbalances can be found in the statistics of world shipping trade in liner shipping as well as in bulk cargo shipping. Such figures indicate that in spite of multilateral efforts to correct distortions in the shipping market and to ensure greater participation by developing nations, there has been an aggravation of the problems faced by developing countries in effectively securing a greater share of the international market. This can be attributed to a number of factors such as market concentration, technological changes and their impact on shipping, open and parallel registries and the lack of an adequate number of skilled personnel as a result of labour migration and reverse resource transfer. We shall examine some of these problems below.

One of the problems posed by the rapid advancements in technology for developing countries concerns containerization. While about 60 per cent of the world cargo trade is presently containerized, the proportion of devloping country fleets which can transport containerized cargo is extremely modest. In addition to the already existing problems concerning the buying of new ships and the maintenance of old ones, this has burdened devloping countries with the task of making heavy capital investment in containerizing their fleet and in providing other appropriate infrastructures for their operation. Many such countries find that they are losing an increase share of their own trade, as the cargo tends to become increasingly containerized and to be carried by foreign-flag carriers. In Thailand, the Government has encouraged domestic firms to form joint-ventures with foreign firms in order to facilitate the modernization of Thai fleet. In Malaysia and India, the number of foreign and doemstic firms operating in containerized cargo transport reveals the dominance of the former.

One of the ways in which changes in technology have transformed the international shipping industry is through the introduction of containerization in liner shipping. Containerization has meant that

the vessel is now no longer the unit of shipment: it is the container. As a result of this, a strict adherence to traditional trade routes has also become unnecessary. Much of the shipping routes now connect developed-country ports, and there are only feeder services to other ports to enable transhipment of containerized cargo. For developing countries, containerization has caused severe problems in increasing their participation in world trade lin shipping. Containerization involves heavy capital investment, computerized control of operations, new forms of orgnanizational and managerial techniques, and access to modern telecommunications technologies. The immense capital investment that is required to containerize ships has meant that many developing countries have been losing their share in liner shipping. In 1988, while developing countries accounted for 27.6 per cent of the world tonnage in general cargo, their share in containerized cargo was as low as 13 per cent. The resultant asymmetry is highlighted in comparison to developed-country figures: 47.8 per cent and 71 per cent respectively.

The heavy capital investment needed has hindered developing countries from the Asia-Pacific region from taking advantage of the increasing volume of sea-borne trade in the region. Currently, shipping trade between Asia and Europe is the second largest in the world, only being surpassed by the trans-Pacific trade. Despite this, a recent study by ESCAP noted that $5.3 billion would need to be invested in new tonnage by the ASEAN countries by 1992, if they were to maintain their present share in world shipping trade. The corresponding figure for the year 2000 is $15.3 billion. If ASEAN countries were to buy ships that are five to ten years old instead of new ones, the investment required will come down to $3.7 billion and $8.4 billion for 1992 and 2000 respectively. However, these figures do not include the cost of repair or of replacement of existing ships. Given the high cost of shipbuilding, countries in the region find it extremely hard even to maintain their trade share in shipping through adequate tonnage.

The problems are further aggravated by the financial needs of infrastructural investment. To keep up with the increasing volume of containerized cargo, several Asian countries have been bulding container ports. Hong Kong has adopted a series of measures for the development of its port as well as airport, and they include the building

of container terminals for the port. Thailand is bulding a new container port at Laem Chabang. In order to cope with the port congestion problems at Bangkok, Thailand has allowed the private sector to run extra wharves as well as made the navy port at Sattalip temporarily available for use. Even with the new container port, it is estimated that Thailand will find it difficult to keep up with the increasing volume of trade. The bulding of a new port at Krabi is under consideration. However, this would raise another sort of problem. Ninety per cent of Thailand's exports are manufactured in Bangkok and, consequently, expansion to economically disadvantaged areas will require adequate infrastructure facilities such as roads. These would again involve substantial investment.

Another area where the volume of shipping trade in Asia has shown prospects of growth is that of entrepôt trade. Entrepôt trade in Asia amounted to 1.5 million teu in 1988, and is bound to grow as many manufacturing firms from countries in the region are shifting their production offshore. Japan's example in this has been followed by Taiwan, Hong Kong and the Republic of Korea - Philippines and Thailand being the principal locations of these facilities. It is estimated that Asia's entrepôt trade will grow in the coming years at an annual rate of 10 to 15 per cent. The trade between some individual countries is expected to grow at an even faster pace. It is estimated that the trade from Hong Kong to Thailand will grow from 100o teu in 1988 to 3000 teu in 1992. The trade from Philippines to Hong Kong is expected to grow at annual rate of 28 per cent.

In spite of these prospects, rates in entrepôt trade have been kept down by short distances and intense competition. It is also argued that big operators have not formalized specific routes except for relatively short-term opportunities. Most of the intra-Asian shipping trade is conducted through feeder vessels, though some of this is handled by vessels making short calls at the end of trips from the United States or Europe. This has partly to do with the geographical peculiarities of the region, which can only be covered in a series of short loops using smaller vessels, rather than by large vessels dedeicated to end-to-end economic efficiency.

Many countries in the region are undertaking reorganization of the regulatory structure in their domestic shipping sectors. We have

noted Thailand's incorporation of the private sector in solving the port-congestion problems at Bangkok. Indonesia has allowed foreign carriers into the protected domestic market, and has also allowed domestic lines to organize their schedules in response to the market, rather than in accordance with rigid and uneconomic schedules. Philippines too is considering a revision of its shipping regulations. These efforts at liberalization will indeed have an impact on trade in the region, especially entrepôt trade. The creation of a single market in Europe in 1992 is also expected to generate more trade in shipping between Asia and Europe. It has been suggested that Europe will then open up to produce a market similar to that in the United States, with tariff barriers removed, and with a fifty per cent larger population providing more consumers.

However, the low rates in shipping has raised the anxiety of overcapacity in relation to container facilities, especially in Hong Kong. It has been argued that the growth in container shipment as a replacement for break-bulk shipping is almost over, and that future growth will have to come from increases in trade. One hope is that the higher value-added end of the market will eventualy push up yield on more trade, thus justifying the capacity increase already in place in Hong Kong and Singapore.

I. INDIAN SHIPPING SCENE

As on 1 January 1990, Indian merchant fleet consisted of 405 ships comprising 5.9 million grt. In mid-1989, in terms of the overall tonnage inclusive of fishing vessels, dredgers, tugs, etc., the Indian fleet ranked sixteenth in the world; exclusive of open-registry fleets its rank was twelfth. Among developing countries, the Indian fleet was the fourth largest fleet.[1] Indian tonnage in world tonnage has increased over the last two decades. In 1950, the Indian fleet constituted 0.5 per cent of the total world fleet. In 1989 the share of the Indian fleet was 1.54 per cent.

1 Llyods Register of Shipping Statistical tables, 1989.

A. Coastal and overseas fleet

On 1 January 1990, the number of ships and their tonnage employed in coastal and overseas trades by India were as follows:[2]

Indian fleet as on 1 January 1990

	No.	grt (million)
Ships employed on coastal trade	151	0.477
Ships employed on overeseas trade	254	5.445
Total	405	5.922

Though, in terms of numbers, 37.3 per cent of the fleet was on the coast, in terms of tonnage this was only 8.1 per cent. The average size of a coastal ship was only 3,159 grt whereas in the overseas trade this was 21, 437 grt.

B. Composition of Indian fleet

Table 1 shows the composition of the Indian fleet as between different types of ships. The Indian fleet has been fairly diversified in an effort to cater to a variety of domestic needs.

The profile of the Indian fleet is considerably different from that of the world fleet. Bulk-carrier tonnage constituted 39 per cent of the total Indian tonnage in 1989, while it formed only 27 per cent of the world tonnage. Tanker tonnage constituted the largest segment of world fleet, comprising 32 per cent of the total world tonnage in 1989.

2 Directorate General of Shipping, Ministry of Surface trance, Government of India, Quarterly statement of Indian shipping tonnage.

Though forming a very substantial component, tanker tonnage comprised 28 per cent of the total Indian tonnage.[3]

A comparison of the average size of ships in the Indian and world fleet as of 31 December 1989 indicates that the average size of a tanker in the world fleet is almost twice the average size of an Indian tanker. The dissimilarity in the average size of bulk carriers in the Indian and world fleet, while not so marked as in the case of tankers, is still significant, the average size in the world fleet being about 18 per cent larger than the average Indian bulker.

The fleet composition and average size of tankers and carriers in the Indian fleet are different from that in the world fleet because Indian fleet has been developed basically to cater to Indian trade and because its participation in cross trading is minimal. The Indian fleet is tailored to domestic port conditions and to the pattern of India's seaborne trade.

C. Number of shipping companies

The number of shipping companies in India declined from 35 in 1970 to 31 in 1972, after which their number has increased rather rapidly. The number rose steeply from 32 in 1973 to 56 in 1977. Thereafter the rate of growth somewhat declined. By 1984, the number of shipowing companies was 69, the highest ever. In the post-1984 period a decline set in, perhaps reflecting the impact of the deep and prolonged depression in the freight markets. By the end of 1989, only 50 shipowning companies were in existence.

Most of the companies which mushroomed after 1973 own less than five ships each. In fact, many of these owned only one or two ships each. Moreover, most of the companies which went out of business after 1984 were also smaller companies owning less than 5 ships. Thus, bigger companies appear to have been more resilient and were able to cope with the rigours of prolonged market depression better than smaller units.

3 Lloyds Register of Shipping Statistical Tables, 1989.

D. Indian companies and their fleet composition

Most Indian shipping companies own only bulk carriers, the preferred size range being 15,000 to 30,000 dwt. About 32 per cent of the Indian-owned overseas bulk carrier tonnage have this size, and many of the smaller companies have only this type and size of ships in their fleet.

Seven companies own the entire Indian overseas tanker fleet. Four companies, three of them owning overseas tankers, own all the ore-bulk-oil (OBO) carriers. Only three companies accounted for more than 98.3 per cent of the Indian liner tonnage. The entire off-shore supply vessel fleet was owned by seven shipowning companies.

E. Government policies

Government policies have had a significant bearing on the development of the Indian shipping industry and on its role in the national economy. India has followed the path of centralized planned development since the country's first five-year plan was launched in 1951. Each successive five-year plan has set up targets in various fields including the development of the national merchant fleet and provided a financial outlay for this purpose. Government permission is required for the acquisition of a ship by an Indian company. Plan targets and the prevailing position regarding their likely fulfilment are kept in view by the Government, along with other criteria, while granting this permission.

F. Shipping Development Fund

A scheme for the grant of loans to shipping companies for the acquisition of ships was instituted in 1951, and was continued from year to year on an *ad hoc* basis until 1958. In 1958, it was decided that the scheme should be continued as a long-term measure of assistance to the national shipping industry, and the Government set up a statutory and non-lapsable Shipping Development Fund under the Merchant Shipping Act to provide a continuous source of finance for the acquisition of ships and long-term refinancing facilities on soft terms.

Later the Shipping Development Fund Committee (SDFC), the Government agency administering this fund, also took over the function of providing guarantees to shipyards and commercial banks from whom Indian companies obtained credit for the acquisition of ships.

The Shipping Development Fund has played a major role in the development of the Indian shipping industry. The Fund received budgetary allocations from the Government of India. These budgetary grants, as well as loan repayments and interest received by the Fund from loanee shipping companies, constituted the source of finance for SDFC. These were ploughed back into business for further lending. The Shipping Development Fund provided loan assistance to both private and public sector companies. While considering loan requests, the SDFC, apart from examining the viability of the project, also examined the cash-flow position of the company requesting a loan. Loan was refused or the loan amount normally admissible was reduced if it was felt that the company concerned could acquire a ship without loan assistance from the Fund or with a smaller loan amount. This approach was founded on the development nature of the Shipping Development Fund, as it was felt that financially sound companies could fend for themselves while a company with relatively weaker financial resources, or a company whose financial resources were already fully committed, should get preference in the allocation of loans from the Shipping Development Fund. Consequently, the same company, depending upon its cash-flow position, would receive loan assistance from the Shipping Development Fund for the acquisition of a ship and may not receive a loan in respect of another ship at another point of time.

G. Impact of shipping recession

During the prolonged depression in the shipping industry, the financial structure of shipping companies came under severe strain, and many companies defaulted in the repayment of loans and interest. Attempts were made at the rescheduling of loan repayments, but it was found that for several companies even this assistance would not be adequate to keep them afloat. The stake of the Government in the shipping industry was large; loans advanced to private-sector shipping

companies from the Shipping Development Fund, or guaranteed by SDFC totalled Rs. 616 crore (about $480 million).[4]

H. Shipping Credit and Investment Company of India

The Government reviewed the situation, and in April 1987 SDFC was replaced by Shipping Credit and Investment Company of India Ltd. (SCICI). Although the guiding principle of SCICI remains the same as that of SDFC, important changes have also been introduced in terms of norms and practices. While SDFC was entirely funded by the budgetary alloacations of the Government, SCICI is required to find its own resources for its operations. Though it did receive loans on a rather modest scale from the Government, SCICI has also raised funds by borrowing in the Indian market in Indian rupees and in foreign markets in foreign currencies. SCICI can also claim from the Government the difference between the interest rate at which it borrows and the rate at which it lends to shipping companies in persuance of the policy to provide loans on soft terms. The current rate of interest charged by SCICI is 7.5 per cent per annum, which was also the lending rate charged by the SDFC.

Another important difference is that while SDFC provided loan assistance to both public-sector and private-sector shipping companies, the role of SCICI is confined to the private sector alone. Public-sector companies receive loan assistance from the Government to supplement funds generated by them from their internal resources, credit obtained from shipyards and market borrowings. SCICI, being a commercial entity itself, is required to operate on a commercially viable and reasonably profitable basis. SDFC, on the other hand, was not a commercial company.

One of the major tasks entrusted to SCICI was to review the current condition of private sector shipping companies and to make recommendations to the Government on the prospects of survival of ailing shipping companies. There was a large Government stake in these companies in the form of loans and of guarantees for commercial loans provided by the erstwhile SDFC. SCICI took up a review of 16

4 Converted at exchange rate of $1 = Rs. 17.

companies which were in a poor financial condition and which had applied for rehabilitation assistance. The review indicated that while seven companies were potentially viable, nine companies were not suitable for rehabilitation. In the light of more favourable market conditions since then, the cases of three out of the nine companies are being currently reviewed.

SCICI evolved a special rehabilitation strategy for each individual company. The package included the conversion of part of the debt into interest-free loan and the conversion of arrears of interest into subordinated (quasi-equity) loans, with flexibility regarding repayment schedule in accordance with the cash flow of the company. The package also provided for a close monitoring of the performance of rehabilitated companies and for an acceleration of the agreed pace of debt repayment, if it is warranted by improved cash flow.

The rehabilitation package provided by SCICI to the shipping industry, aided by favourable freight market conditions, has achieved a fair measure of success. Of the defaulted amount (principal and interest) of approximately Rs. 319 crore (about \$188 million)[5] in March 1987, about Rs. 175 crore (about \$103 million) was recovered until March 1989. In 1989, dry bulk cargo markets were fairly buoyant and, since most Indian private sector shipping companies predominantly own bulk carriers, more of the outstanding defaulted loans may have been recovered by now.

I. Cargo support

Governments and public-sector enterprises generate large trade volumes, especially in the import sector, the major commodities being crude oil, petroleum products, manufactured fertilizers and raw materials for the fertilizer industry, foodgrains (a major item in the past, but now a relatively minor item), coal for the steel industry, vegetable oil, machinery and equipment for various government-controlled projects (although, projects set up by private-sector companies have been increasing in number and magnitude, these are outside the purview of the controlled cargoes), part of iron and steel imports and defence equip-

5 Converted at exchange rate of \$1 = Rs.17.

ment. On the export front, the participation of governmental agencies is on a modest scale. It has been the Government policy, implemented with varying degrees of success in respect of individual commodities, to buy on f.o.b. terms and to sell on c.i.f. terms as far as possible in order to secure control over the shipment of cargo so that the governmental agencies can exercise, like any other buyer or seller, commercial choice to nominate the carrier.

Cargoes under the control of the Government or government agencies are preferentially alloted to Indian shipping companies at competitive rates. With regard to liner cargoes, freight rates are determined by conference tariffs, or lower special rates may be negotiated. Cargo support is related to Indian-flag and therefore government cargoes are available to Indian companies in the private sector as well.

The policy has been based on following guiding principles:

- Securing the lowest possible freight rates by centralizing arrangements for the shipment of government-controlled cargoes with an agency of the Government (Transchart) which has become one of the important charterers in the shipping sector;

- Conserving foreign exchange outgo on freight account, taking into account the adverse balance-of-payments position of the country;

- Strategic considerations, specially with regard to crude oil and petroleum products, as dependence on foreign carriers can be very unreliable for national security and for the economy of the country in difficult times;

- Supporting the development of the Indian shipping industry through a measure of cargo support which is regarded as the least expensive method for the promotion of national merchant marine and as being in line with a widely prevalent commercial practice in the world;

- Ameliorating to the extent possible the competitive disability with which Indian shipowners suffer on account of distortions which have been built into world shipping markets, mostly due to policies persued by developed countries and to their financial, economic and commercial strength; and

- Perhaps the most important factor is that the Indian shipping industry has been developed basically to serve India's national seaborne trade; the focus has always been on national needs.

Transchart made shipping arrangements to cover 21.3 million tonnes of cargo in the year 1988. Despite the Government policy of giving preference to Indian-flag vessels for the carriage of these government-controlled cargoes, no less than 41.6 per cent of these cargo es were carried by foreign-flag vessels. Indian-flag vessels carried 55.4 per cent. Exclusive of crude oil and petroleum products, foreign-flag vessels carried 52 per cent of Transchart cargoes. The fact that such a large share of government-controlled cargoes was carried by foreign-flag ships shows the flexible pragmatic manner in which the Government policy has been applied and the primacy given to serving the needs of cargo interests. It is also relevant that not all government-controlled imports have been purchased on f.o.b. terms. For example, in 1988/89, about 3.8 million tonnes of vegetable oil and phosphoric acid were purchased on c.i.f. terms by governmental agencies.

J. Cabotage

India follows the widely prevalent international practice with regard to cabotage. In fact, this policy was originally implemented during the days of colonial rule, and it has continued. Cargoes moving between Indian ports are reserved for Indian-flag ships unless a dispensation to the contrary is given by the competent Government authority, i.e. the Director-General of Shipping. Relevant extracts from Section 407 of the Merchant Shipping Act are reproduced below:

> (1) No ships other than an Indian ship or a ship chartered by a citizen of India (or a company or a co-operative society which satisfies the requirements specified in clause (b) or, as the case may be, clause (c) of Section 21), shall engage in coasting trade of India except under a licence granted by the Director General under this Section.
>
> (2) A licence granted under this Section may be for a specified period or voyage and shall be subject to such conditions as may be specified by the Director General.
>
> (3) The Central Government may, by general or special order, direct that the provisions of sub-section (1) shall not apply in respect of any part

of the coasting trade of India or shall apply subject to such conditions and restrictions as may be specified in the order.

K. Chartering of ships

Since exchange-control regulations are involved, Government permission is necessary for the chartering-in of foreign-flag ships and for the chartering-out of Indian-flag ships to foreign companies. Government authority in this respect has been delegated to the Director-General of Shipping at Bombay, where most of the important national shipping companies are located. Chartering-in of foreign-flag ships and chartering-out of Indian ships to foreign parties are fairly common, and the Director-General of Shipping is guided by pragmatic commercial considerations and the need to maximize the conservation and earning of foreign exchange.

L. Pattern of India's foreign seaborne trade

On the demand side, the structure of India's foreign trade generates different types of requirements in terms of type and size of ships. Table 2 shows the tonnage of cargo moved in India's overseas seaborne trade for general cargo, crude oil, petroleum products and other bulk cargoes in the years 1976-77 and 1988-89.

The trade pattern differs very widely, depending upon different types of cargoes. Crude oil and petroleum products constitute the largest single import item. The largest single item of exports is iron ore, amounting to 33 million tonnes in 1988-89. With regard to dry bulk cargo imports, manufactured fertilizers and raw materials for the fertilizer industry constitute the largest part of the cargo, amounting to 5.3 million tonnes in 1988-89, followed by coking coal (3.6 million tonnes).

With regard to general cargo, the volume of imports was more than twice the volume of exports in 1986-87. However, this gap is expected to narrow down in future and the rate of growth for general cargo exports is expected to be the highest among all subsectors of national trade. In terms of tonnage, general cargo exports constituted only 13 per cent of seaborne export cargoes and 14 per cent of import seaborne cargoes. However, a rough analysis shows that, in terms of

value, the share of general cargo was about 87 per cent in the export sector of seaborne trade.

Table 3 shows the profile of India's export and import trade in the years 1986-87 to 1988-89 in terms of tonnage and its distribution in three main groups, viz. dry bulk cargoes, liquid bulk cargoes and general cargoes. The table also shows the percentage share of these cargoes carried by Indian shipping lines.

There is a wide disparity in the share of Indian lines in the carriage of national trade as between export cargoes and import cargoes. The highest share of the Indian lines has been in respect of the import of POL and other bulk cargoes. However, even this share has declined from 78.4 per cent in 1986-87 to 66.2 per cent in 1988-89. The oil industry in India is in the public sector and crude oil and POL products are imported exclusively by public sector enterprises which buy on f.o.b. terms and exercise their commercial right to nominate Indian-flag ships. The oil industry, as elsewhere in the world, could have owned its own tankers, but as a matter of policy the Government decided that these should be owned and operated by specialist shipping companies.

The next largest share of Indian lines is in the import of dry bulk cargoes. Most of these cargoes such as manufactured fertilizers, raw materials for the fertilizer industry such as rock phosphate and sulphur, and coking coal are bought by the Government or public-sector entities, and the shipment of these cargoes is arranged by Transhcart, the chartering wing of the Ministry of Surface Transport of the Government of India. Transchart gives preference to Indian-flag ships in the allocation of these cargoes, but it also employs foreign-flag ships extensively. It is noteworthy that in the category of dry bulk exports the Indian-flag share is rather modest, only 17 per cent in 1988-89, despite India owning a sizeable bulk carrier tonnage of 2.6 million grt, because most of the export cargo shipments are controlled by foreign buyers who buy on f.o.b. terms.

The lowest share for Indian lines is in the category of general cargoes. The share of Indian lines has declined rather steeply in this sector, from 21.9 per cent in 1986-87 to only 14.2 per cent in 1988-89. This low share is primarily due to excessive, and sometimes unhealthy, competition. As of March 1990, as many as 60 foreign shipping lines

provided liner services to India, 38 of them providing only container services. As against these, only three Indian shipping companies are involved in major liner-trade routes and only one of them (Shipping Corporation of India) operates container services. Besides these three major lines, several small Indian companies are serving nearby trade routes to the Persian Gulf and Red Sea areas. Taking into account the relatively small volume of liner trade generated by India, the number of shipping companies operating in Indian trade is very large. This is because of India's geographical location midway between the world's two largest trading blocks, viz. Europe and the Far East, and close to Persian Gulf which has a large import trade but hardly any export liner cargoes.

Control over cargo seems to be the decisive factor in determining the choice of carrier. In the case of India, the share of Indian lines was 34 per cent, primarily because of the high share of Indian lines in the carriage of crude oil and petroleum products, the oil Industry in India being in the public sector. Exclusive of these cargoes, the share of Indian lines was only 20 per cent.

M. Bilateral shipping treaties

India has bilateral inter-governmental shipping treaties with USSR, Czechoslovakia, Poland, Egypt and Bulgaria. These treaties provide for cargo sharing between the national shipping lines of India and the shipping lines of the trading partners. Some treaties provide for the entire cargo to be lifted by the two trading partners, while others provide for a cargo share of 40 per cent each for the trading partners, leaving 20 per cent for third-flag countries. However, bilateral treaties cover only a small percentage of the total Indian trade - about 11 per cent in 1986-89.

N. The Shipping Corporation of India

The Shipping Corporation of India (SCI), a company in the public sector, dominates the Indian shipping industry. The SCI is also one of the largest and most diversified shipping companies in the world. In the early 1950s, the Government found that, despite encouraging policies, the national shipping tonnage was increasing only at a slow

pace. Therefore, the Government decided to set up public sector companies. Eastern Shipping Corporation and Western Shipping Corporation were established in 1950 and 1956 respectively, and they were amalgamated to form the SCI in 1961. The SCI expanded rapidly and soon came to acquire a substantial share in the Indian shipping tonnage. Table 4 shows the number of ships and tonnage owned by the SCI and its share in the national tonnage.

In recent years, the SCI has also emerged as an important ship management company. As of March 1990, the SCI manages 27 vessles belonging to other Government departments and public sector enterprises. The SCI operates 20 different types of ships - few companies in the world operate such a diversified fleet. The SCI is the only shipping line, Indian or foreign, which operates regular liner services between India and all her major trading partners.

A comparison between the tonnage owned by the SCI and by private-sector Indian shipping companies indicates that the SCI fleet is dominant in respect of crude-oil tankers and general cargo tonnage, whereas private-sector companies own more bulk carriers, OBOs and product-carriers tonnage, especially bulk carriers. Relevant data are compiled in table 5.

The predominant position of the SCI with regard to crude-oil tankers is due to a policy decision taken by the Government in the 1960s that the public sector refineries should be serviced by public sector shipping companies, on account of the strategic importance of the oil industry to the national economy. All the shares of the SCI are owned by the Government of India. But the company is managed on commercial lines, and over the years it has become the nursery for shipping expertise in the country. There are few companies in India in shipping and allied fields which do not employ former SCI executives. A large number of former SCI officers are also employed by foreign shipping companies. The SCI has been a profitable venture. Since its inception in 1961-62, the SCI has earned net profits after tax in 24 years.

In 1973, a private sector company, Jayanti Shipping Company Ltd., which had earlier been taken over by the Government to improve its management, was merged with the SCI. In 1986, another public sector company, Mogul Lines Ltd., which had incurred large losses, was

also merged with the SCI. Self-generated financial resources which were ploughed back into business have played a key role in the expansion of the company. The estimated sources of the capital outlay of the company as on 31 March 1989 are shown below:

Percentage of sources to the total capital outlay of the SCI as on 31.3.1989

	Source	*Percentage share*
1.	Share capital	3.3
2.	Internal resources	37.8
3.	Funds borrowed from the Government	34.0
4.	Commercial loans and credits	24.9

During the seventh five-year plan of the country (1985-86) - the SCI made remarkable all-round progress, which is reflected in the figures compiled in table 6 which compare the company's performance in the seventh plan with the sixth five-year plan period (1980-81 to 1984-85). It is noteworthy that even during the worst period of recession in the shipping industry which coincided with the sixth plan when the SCI incurred an aggregate net loss of Rs. 45 crore (about $26.5 million),[6] the company made a net foreign-exchange contribution (earning and saving of foreign exchange) to the national economy after providing for outgo on capital account and payment of interest. The company was also able to set aside substantial sums of money on account of depreciation during this period.

O. Performance of private-sector shipping companies

The financial performance of ten major Indian private shipping companies for five years (1984-85 to 1988-89), amount to 1.94 million grt, comprising 58 per cent of the total number of ships owned by private sector shipping companies as on 1 January 1990 and 69 per cent

6 Converted at exchange rate of $1 = Rs. 17.

of their total tonnage. Four companies earned profit after tax throughout the five-year period. One company has incurred loss every year. The performance of the remaining five companies presents a mixed picture; they have earned profits in some years and incurred losses in others. But for all companies, the results of the financial year 1988-89 were better than those in the previous year; either the profits increased, or the losses were reduced, reflecting an improvement in the freight market.

P. Shipment account in balance of payments

International Monetary Fund (IMF) *Balance-of-Payments Satistics* for the year 1985 shows under 'Shipment' a credit of SDR 1401 million.[7]

II. SHIPPING IN THAILAND

A. Composition of Thai merchant fleet

In 1989, the Thai fleet comprised 272 ships aggregating 0.54 million grt.[8] In the year 1989, in terms of tonnage, the Thai fleet was ranked fifty-eighth among the world merchant fleets including open-registry fleets; the rank was fifty-three excluding open-registry fleets.

General-cargo ships dominate the fleet, contributing 66 per cent of the total tonnage and 40 per cent of the number of ships in 1989. They also formed the main growth point of the Thai fleet, and their share in the total Thai tonnage, which was 60 per cent in 1979, increased to 66 per cent in 1989. There were no container ships in the year 1979. Container ship tonnage has increased from 4374 grt in 1981 to 36,362 grt in 1989.

The oil-tanker tonnage has declined from 58 tankers totalling 142,934 grt in 1981 to 67 tankers aggregating only 69,906 grt in 1989, but oil-tanker tonnage still forms the second largest segment of the Thai

7 *IMF Balance-of-Payments Statistics, 1987.*

8 Lloyds Register of Shipping Statistical Tables, 1989.

fleet. Though the tanker tonnage is rather modest, their number is farily large, i.e. 67 in 1989. Thailand is an important exporter of dry bulk cargoes like rice, tapioca and timber. Rice is generally exported in bagged form. However, since 1978, Thai fleet has possessed no bulk carriers except for one or two ships from 1984 to 1987. In terms of numbers, liquified gas carriers are also a significant component of the Thai fleet even though their tonnage declined from 35,303 grt in 1986 to 24,113 grt in 1989.

B. Size and age profile of fleet

Most of the Thai-owned ships are small in size. About 75 per cent of the dry-cargo ships were under 10,000 dwt and only 23 vessels were larger than 10,000 dwt in 1988. Thai fleet is also old, and according to an analysis prepared by the Maritime Transport Promotion Commission of Thailand, about 34 per cent of the dry-cargo, tanker and gas carrier fleet is 15 to 20 years old. Almost half of the fleet is even older.

Thai oil tankers and gas carriers are also very old and small in size, and almost all of them operate on Thailand coastal trade only, though a few product carriers are also used for transporting petroleum products from Singapore, Malaysia, Indonesia and Brunei to Thailand.

C. Development of Thai fleet

A rough assessment indicates that almost 60 per cent of the Thai dry-cargo fleet is deployed in intra-ASEAN trade, 35 per cent in trade with Japan and the Republic of Korea, and about 5 per cent in trade with Hong Kong and Taiwan, Province of China. Most of the ships are used for tramp operations. Only one company (United Thai Shipping Corporation Ltd.) has deployed two general cargo ships in the Far East/Europe liner trade. Most of the container ships are employed in operating feeder services, generally to Singapore. Coastal movement of dry cargoes is small, mostly comprising rice; often the same ships carry part of the cargoes to Malaysian ports.

D. Shipment account in the balance of payments

International Monetary Fund (IMF) *Balance-of-Payments Statistics* for the year 1986 shows under the head 'Shipment' a credit of SDR 292 million and a debit of SDR 940 million for Thailand; thus the net deficit on this account was SDR 648 million.[9]

E. Organisation of Thai shipping industry

Thailand has 74 shipping companies, 39 of them in dry-cargo trading and 35 in petroleum trade-oil products or LPG. On average, a Thai company owns only 2 ships and most of the companies own only 1 or 2 ships each. Only 15 companies own more than five ships.[10]

The bulk of the Thai fleet is privately owned. In fact, most of these are said to be family-owned entities and only two are listed on the stock exchange. Two companies have Government participation. In Thai Maritime Navigation Co. Ltd., the Government of Thailand owns 99 per cent of the share capital. This company is said to have incurred losses for several years, and now owns only one 1953-built ship. In United Thai Shipping Co. Ltd., the Government has a share of about 40 per cent. This company operates two liner ships on Far East/Europe and United Kingdom Eire/Far East routes, and now functions as a non-conference outside.

F. Cabotage

Cabotage forms part of the maritime policy of the Government of Thailand. This is reflected in the Thai Vessels Act B.E. 2481 (1938) which reserves carriage of cargo in Thai waters from one port to another for Thai-flag ships only. The Act also requires that the crew of these vessels should be of Thai nationality. The Ministry of Transport and Communications is empowered to grant temporary permission for operating foreign-flag ships in coastal trade. Such permission should not exceed one year at a time. It is also understood that foreign-flag ships

9 *IMF Balance-of-Payments Statistics, 1987.*

10 Thai Shipowners' Association Directory, 1990.

deployed in international trade are permitted to call at only one Thai port during the course of a voyage and are not permitted to load or discharge cargo in more than one Thai port in the same voyage.

G. Cargo support

Maritime Promotion Act B.E. 2521 (1978) reserves the import of government cargo to Thailand to be carried in Thai vessels on following specified routes:

- from Japan;
- from the Republic of Korea;
- from Taiwan, Province of China;
- from Hong Kong;
- from Norway, Sweden, Finland, Denmark, United Kingdom, Federal Republic of Germany, Netherlands, Belgium, France, Spain, Italy, Portugal, Singapore and Malaysia; and
- from the United States.

However, if a suitable Thai vessel is not available, then a dispensation can be obtained to ship the cargo by a foreign-flag ship from the Office of Mercantile Marine Promotion Council of Thailand. A permanent dispensation in this regard can also be issued by the Minister of Communications. Such dispensation has been granted in the case of oil and petroleum products. It has also been granted in the case of cargoes purchased with foreign aid or loans. That petroleum oil cargoes are exempted from the scope of cargo preference perhaps reflects the ownership of the oil refineries in Thailand. Of the three oil refineries in the country, one is owned by a multinational company. Another, which has a 49 per cent Government share holdings, is managed by another multinational company. The third refinery is, however, owned by the Government.

Most of the government-controlled import cargoes are reported to be general-cargo goods. Freight rates are based on the current

liner-conference freight tariffs and on market freight rates if there is no liner conference on a specific trade route.

H. Cargo share of Thai national shipping lines

An estimate prepared by the Maritime Transport Promotion Commission indicates that the share of Thai-flag ships in the carriage of the country's foreign seaborne trade, in terms of tonnage of cargo, is small. Annual estimates for the period 1984 to 1988 are shown in table 7.

The share of Thai-flag ships in the total freight generated by the country's trade must be even lower because of the rather limited participation of Thai-flag ships in the carriage of liner cargoes. It is relevant that according to a rough estimate made by Thai Maritime Promotion Council, about 60 per cent of the total outgo is on account of containerized cargoes and, in this sector, Thai-flag participation is very modest. Besides, Thai container fleet is generally confined to operating only feeder services to Singapore.

I. Government policies

The Government of Thailand exempts shipping companies from the payment of corporate tax, generally upto a period of eight years after the acquisition of a ship. Concessions are approved by the Board of Industries at the time of the approval of the project, and generally ships which are more than ten years old are not entitled for tax exemption. There are no restrictions on import, export, chartering-in or chartering-out of ships by Thai shipping companies.

According to the Secretary-General of the Merchant Promotion Council of Thailand, while in the past the main task of the Council was to promote the development of Thai shipping industry, now it has become the promotion of the country's exports. This change in emphasis obviously reflects the emergence of Thailand as an important exporting country. However, Government policy continues to support the expansion and modernization of the Thai fleet. Since Thai entrepreneurs have recorded only limited success in this field so far, they are being encouraged to seek assistance from foreign companies and to form joint

ventures. The short-term objectives of the promotion policy are as follows:

- A significant component of the Thai fleet should be container or semi-container ships;
- The fleet composition should be made younger and ships more than 25 yeras old should be replaced; and
- Thai shipping lines are encouraged to enter Thailand/North America and Thailand/Europe liner routes to serve the trade between Thailand and its major trading partners.

It is also proposed that small shipping companies be merged to form bigger and stronger companies which would also minimize wasteful competition among them. A plan has been initiated to bring together two companies which have Government capital participation, viz. Thai Maritime Navigation Company and United Maritime Navigation Company. It is hoped if the plan succeeds, this will encourage private sector companies to develop similar plans.

III. SHIPPING IN MALAYSIA

A. Malaysian fleet

On 1 January 1989, the Malaysian fleet comprised 491 ships aggregating 1.7 million grt. Malaysian fleet occupied the fortieth rank among world fleets; exclusive of open registries, its rank was the thirty-fifth.[11] *IMF Balance-of-Payments Statistics* for the year 1986 shows under the head 'Shipment' a credit of SDR 380 million and a debit of SDR 840 million for Malaysia; thus, the net deficit on this account was SDR 460 million.[12]

The composition of the Malaysian fleet as on 1 July 1989 is shown in table 8. General cargo ships dominated the fleet with a 24 per cent share in the total tonnage closely followed by bulk carriers (21

11 Lloyds Register of Shipping Statistical Tables, 1989.

12 *IMF Balance of Payments Statistics, 1987.*

per cent). However, in line with the pattern of the country's foreign trade, the fleet includes several specialized ships like chemical tankers, gas carriers and cellular container vessels.

General Cargo ships have dominated the Malaysian fleet since 1960, though their share in the total tonnage has decreased from 31 per cent in 1950 to 24 per cent in 1989. However, the container fleet, though still rather modest, has shown high growth, from a tonnage of only 0.11 million grt in 1980 to 0.20 million grt in 1989. Bulk-carrier tonnage, which is the next largest segment of the fleet, grew rapidly from 1979 to 1987, but thereafter it has declined. Gas carriers were introduced in 1961 and have since then become an important part of the fleet. Because of the geography of Malaysia, in terms of numbers, fishing vessels, ferries and passenger vessels have always formed a significant component of the Malaysian fleet.

B. Malaysian International Shipping Corporation Berhad (MISC)

MISC is the dominant shipping company in Malaysia. At the beginning of 1990, this company owned 45 ships comprising 0.94 million grt, which was 56 per cent of the total Malaysian tonnage. The company was established in 1968 with the twin corporate objectives of engaging in international and intra-Malaysian trades. Important objectives were to contribute towards reducing Malaysia's dependence on foreign shipping services, towards improving the balance of trade by reducing freight outgo to foreign shipping lines and towards earning foreign exchange. MISC is also geared to support and implement the Government policy on cabotage by providing efficient intra-Malaysian coastal services on a competitive basis in order to strengthen the economic link between Peninsular and East Malaysia.[13]

The composition of the MISC fleet as of April 1990 is given in table 9.[14] The company owns several specialized ships like container vessels, liquified natural gas (LNG) carriers, parcel tankers, chemical tankers, catamaran/crew boats and anchor-handling supply vessels.

13 MISC, "Bulk and Tanker Services".

14 MISC, 1989 Annual Report.

Starting off with two general cargo ships at its inception, MISC has grown into a diversified fleet in line with the varied requirements of Malaysia's foreign and coastal trade.

MISC was established as a government-owned company, but from its very inception the company has also had some private shareholding. However, in line with the current policy of the Government of Malaysia to encourage privatization, the shares of the company were listed in Kuala Lumpur Stock Exchange for the first time in February 1987. Nonetheless, the Government and governmental institutions still own a majority share in the company. At present, the Government, the Bank of Nagara Malaysia and related agencies own 54 per cent of MISC shares. Individuals and companies own 16 per cent and foreign persons own the remaining 30 per cent.[15]

MISC is a viable and profitable enterprise, and has earned net profit every year during the last decade, except in the years 1982 and 1985. Profits have been increasing rapidly every year since 1985. In 1989, the net profit after tax rose to 430.7 million riggits from 390.2 million riggits in 1988. Consequently, the debt/equity ratio improved from 1.5:1 in 1988 to 1:1 at the end of 1989.[16]

Each segment of the company's activities showed profit in 1989 except the offshore oil sector; but the company expects to earn a profit in this trade too in 1990. Three gas carriers owned by the company are engaged in a profitable long-term 20 year charter for carrying LNG on c.i.f. terms from Malaysia to Japan. A very substantial portion of the company's turnover and profits are derived from this lucrative charter.

C. Perbadanan National Shipping Line Berhad

This company is fully government-owned and was established in 1982. The company owns a fleet of 12 ships agrregating about 250,000 dwt. The company regularly supplements owned fleet with chartered tonnage, employing about 6 chartered ships at a time. The company is not engaged in liner shipping and generally carries bulk cargoes like cement, urea and LPG (on Malaysia coast). Of the cargoes carried by

15 MISC Container Services - Leaflets Catalogue.

16 MISC Annual Reports 1989

this company, approximately 60 per cent are Malaysian cargoes; about 10 per cent are cargoes for other ASEAN countries, and the rest are cargoes carried in cross trade. While no published data is available to show the company's financial performance, it is understood that the company has been earning an operating profit although it is unable to provide for full depreciation.

There are no restrictions on the sale and the purchase of ships by Malaysian shipping companies, the chartering-out of Malaysian ships or the chartering-in of foreign ships by Malaysian companies. However, Parnas which is fully government-owned, requires permission from the Government for the sale and purshase of ships. Government permission is also required for the chartering-in of ships on long-term charters by this company.

Malaysian shipping companies are exempt from the payment of corporate tax and of import duties on ships. The wages of seamen are also exempt of income tax. Some interest subsidy is given for ships acquired from Malaysia Shipyard and Engineering Berhad.

D. Cabotage

Cabotage restrictions are a legal requirement and are specially relevant because the country is divided into tow land masses -the Malaysian peninsula and the eastern territories- which are separated by the South China Sea.

E. Cargo support

Government instructions require that cargoes belonging to the Government or governmental agencies should be shipped preferentially by Malaysian-flag ships. The main Government cargoes which are imported are rice, sugar and steel. These are generally purchased on f.o.b. terms; thus the Government exercises a commercial preference in favour of Malaysian-flag ships. Freight rates are required to be fixed according to the prevailing market rates. On the export side, the important government-controlled cargoes are liquefied natural gas (LNG), palm oil and logs. LNG is sold to Japanese buyers on c & f terms and

is carried by LNG carriers owned by Malaysian International Shipping Corporation Berhad under a 20 years contract.

F. Bilateral shipping agreements

The Government of Malaysia has bilateral shipping agreements with the following ten countries which require cargoes between Malaysia and these countries to be carried preferentially by ships under Malaysian flag or by the ships of the trading partner concerned: Turkey, Bangladesh, Pakistan, Sri Lanka, Luxumbourg, USSR, Republic of Korea, Indonesia and China.

G. Cargo share of national shipping lines

Approximate estimates prepared by the Ministry of Communication and Transport show that in the year 1986, approximately only 14 per cent of the seaborne cargo tonnage in the foreign trade of Malaysia was carried in Malaysian-flag ships. It is claimed that even though government-controlled cargoes are required to be preferentially shipped in Malaysian-flag ships, in practice a substantial portion of these cargoes are carried by foreign-flag vessels to meet the commercial requirements of the importers and exporters. For example, according to MISC sources, this company currently carries only about 5 per cent of the country's palm oil exports. It must be clarified, however, that not all palm oil exports are on Government account, though a sizeable quantity is government-controlled. In the liner sector, the bulk of the cargoes are containerized and are carried by foreign-flag ships.

One of the consequences of containerization and of the increasing use of transhipment ports is that direct liner services to smaller ports have been affected. It is reported that ships of Far East Shipping Conference (FESC) have stopped calling at Penang and have announced an additional charge of $250 per TEU on containers to and from this port. This development is resented by the Malaysian Shippers Council who allege that the additional charge has been imposed by the Conference without any consultation with the Council. It is also claimed that industries in the Penang area have been placed at a disadvantage in comparison with industries served by Port Klang because of this additional charge.

Box 1

SHIP REPAIR

Although ships are usually inspected carefully every five years, with the economic life ususally considered as ending some time after the third survey, the safety checks are in general less rigorous in the shippins sector than in the air transport sector. A five-year check on the thickness of plating does not match an X-ray survey of an aircraft's skin in assessing damage caused by corrosion. However, salt water and salt-laden air can take a heavy toll on metal plating, and waves can produce strains on hull plates and supporting frames.

The current trend towards smaller crews has resulted in a reduction of available man hours for preventive maintenance, and ship executives have expressed concern over the safety record of bulk carriers, which appears to be poorer than that of general cargo vessels. Listing 12 vessels that sank and 11 that were damaged, the *Lloyd's Register of Ships* announced this year that it had noted with "increasing concern" a high rate of casualties among bulk carriers in 1990 arising from unknown causes or structural failure. Lloyd's research on the issue indicated several causes for this, including: loss of hull plating from the sides of cargo holds, high rate of corrosion of lower side-frames and their connection to side plating, and chemical interaction between iron ore and coal when they are carried on the same voyage.

A British company has been developing a system that electronically monitors strains on ships' structures while at sea. The system measures the effect of waves slamming into the bow and assesses conditions over the rest of the hull, and thie data is processed and stored for later analysis. Excessive strain on the hull from heavy swells can be seen by watchkeepers, and corrective action such as course change or reduction in speed can be taken. However, the cost of the system, $36,000 per shipand $ 100,000 for a more elaborate version, is such that shipowners might forego its use except in the case of new ships, and shipowners from developing countries might find it difficult to afford.

Indian shippers spend approximately 100 million dollars every year for the repair of their ships at foreign docks, especially in Dubai and Singapore. The repair needs of the shipping industry have steadily increased, as companies continue their attempts to extend the life span of ageing ships.

A new joint venture ship-repair facility is currently being set up in Madras by the Singapore-based Keppel Corporation and the New Delhi-based Chokhani International. The joint venture involves an investment of 82 million dollars, occupies 8000 square metres, and covers a water area of 44,000 square metres. It can handle vessels weighing up to 40, 000 dwt.

Keppel Corporation, whose interests also extend to shipping, property, construction, engineering and financial services, has ship repairing facilities in Singapore as well as the Philippines. It owns 56 per cent and 46 per cent of its subsidiaries in the Philippines, and 25 per cent of the Indian joint venture. The Madras facility is expected to help Keppel in offloading its Singapore capacity, which is overpriced due to high labour costs.

Under the joint venture agreement, Keppel will provide technical and management knowhow to Chokhani International, as well as staff training in Singapore, thus facilitating the transfer of technology and skills. Keppel is also providing marketing support for the joint venture.

Source: ***Far Eastern Economic Review*****, 18 October 1990, and 28 February 1991**

Table 1

COMPOSITION OF INDIAN FLEET

	No.	grt (million)
1. Crude oil tankers	24	1.228
2. Product carriers	38	0.500
3. Bulk carriers	119	2.563
4. Ore-Bulk-Oil carriers	[illegible]	0 544
5. General cargo ships	104	0.810
6. Passenger-cum-cargo ships	15	0.047
7. Cellular cargo ships	3	0.025
8. Offshore supply vessels [a]	57	0.062
9. Acid carriers	3	0.036
10. Timber carriers	3	0.012
11. Others [b]	30	0.095
Total	405	5.922

a Many of these ships have tug and anchor handling capacity.
b Mostly small specialised ships used for offshore oil industry.

Table 2

TONNAGE OF CARGO MOVED IN INDIAN OVERSEAS TRADE

Category	1976-77	(Figures in million metric tonnes) 1988-89
General cargo		
- Imports	2.92	8.12
- Exports	6.71	6.07
- Total	9.63	14.19
Bulk cargo [a]		
- Imports	9.90	19.98
- Exports	25.70	37.44
- Total	35.60	57.42
Crude Oil & Petroleum products		
- Imports	16.60	28.36
- Exports	0.10	1.98
- Total	16.70	30.34
Total trade		
- Imports	29.42	56.46
- Exports	32.51	45.49
- Total	61.93	101.95

Source: Indian National Shipowners Association, Bombay; Directorate General of Shipping, Ministry of Surface Transport, Government of India, Bombay.
a Excluding crude oil and petroleum products.

Table 3

PROFILE OF INDIA'S TRADE

(Quantity (Qty) in million metric tonnes)

	1986-87		*1987-88*		*1988-89*	
	Qty	*Indian lines' percen-tage share*	*Qty*	*Indian lines' percen-tage Share*	*Qty*	*Indian lines' percent-tage share*
Dry bulk cargoes						
- Export	34.70	19.5	32.33	20.1	37.44	17.0
- Import	16.69	37.5	13.10	45.0	19.96	30.7
- Total	51.39	25.4	45.43	27.3	54.42	21.8
Liquid bulk cargoes						
- Export	2.07	21.9	2.47	22.7	1.98	11.6
- Import	19.32	84.5	28.45	75.7	28.36	70.0
- Total	21.39	78.4	30.92	71.4	30.34	66.2
General cargoes						
- Export	4.83	20.0	4.88	17.2	6.07	15.6
- Import	9.51	22.8	8.70	14.7	8.12	13.2
- Total	14.34	21.9	13.58	15.6	14.19	14.2
Total trade						
- Export	41.61	19.7	39.66	19.9	45.49	16.6
- Import	45.52	54.4	50.25	57.2	56.46	47.9
- Total	87.13	37.8	89.93	40.7	101.95	34.0

Source: Directorate General of Shipping, Ministry of Surface Transport, Government of India, Bombay. Indian National Shipowners' Association, Bombay

Table 4

GROWTH OF THE SCI FLEET AND ITS SHARE IN INDIAN TONNAGE

As on	Ships owned by the SCI No.	Grt (million)	Percentage share in national tonnage
2 October 1961	19	0.139	16.2
1 March 1971	66	0.788	32.1
31 March 1981	148	2.965	51.7
31 March 1986	136	3.036	52.3
31 December 1989	126	2.903	49.0

Table 5

COMPARISON BETWEEN TONNAGE OWNED BY THE SCI, PRIVATE SECTOR COMPANIES AND OTHER GOVERNMENT ENTITIES

Type of tonnage	Percentage share to total tonnage		
	SCI	Private companies	Other government entities
Crude oil tankers	96.7	3.3	-
Product carriers	44.5	55.5	-
Ore-Bulk-Oil carriers (OBOs)	47.6	52.4	-
Bulk carriers	27.6	68.4	4.0
General cargo ships	58.7	41.2	0.1
Other ships	14.0	38.7	47.3

Table 6

SCI'S PERFORMANCE IN THE SIXTH AND SEVENTH FIVE YEAR PLANS

	Sixth Five year Plan		Seventh Five year Plan [a]	
	Rs. crore	US $ million [b]	Rs. crore million [b]	US $ million [b]
Aggregate net profit or loss before Indian corporate tax	Loss 45	Loss 26.5	Profit 231	Profit 135 9
Aggregate net foreign exchange contribution [c]	356	209 4	935	550 0
Aggregate internal resources generated	237	139 4	688	404.7

a Estimated.
b At exchange rate $1 = Rs. 17.
c After providing for capital account payments and interest.

Table 7

SHARE OF THAI FLAG SHIPS IN THE CARRIAGE OF COUNTRY'S FOREIGN SEABORNE TRADE

	Percentage share of cargoes carried by Thai flag ships		
Year	*Export*	*Import*	*Total*
1984	11 3	8 5	9 9
1985	11 3	9.3	10.3
1986	10 5	8 8	9 8
1987	11 2	8.7	9 8
1988	9 8	8.5	9.1

Table 8

COMPOSITION OF MALAYSIAN FLEET AS ON 1.7.1989

	No. of ships	*grt (million)*
1. General cargo ships including passenger cargo ships	163	0.392
2. Container ships (fully cellular)	17	0.195
3. Bulk carriers	17	0.347
4. Oil tankers	56	0.162
5. Chemical tankers	4	0.057
6. Liquified gas carriers	5	0.342
7. Fishing vessels	44	0.007
8. Ferries & passenger vessels	31	0.011
9. Others	153	0.155
Total	491	1.668

Table 9

COMPOSITION OF MISC FLEET

Type	*No.*	*grt.*
1. Fully cellurised container ships	12	175,212
2. Palletised cargo coasters	4	11,972
3. Woodchip carriers	2	64,669
4. Multi-purpose bulk carriers	2	36,302
5. Bulk carriers	6	100,184
6. Panamax bulk carriers	2	60,196
7. Parcel tankers	3	56,877
8. Chemical tankers	2	36,906
9. Crude oil tankers	1	44,485
10. Product tankers	3	8,547
11. L.N.G. Carriers	5	340,425
12. Ocean going tug/anchor handling/ supply	1	961
13. Catamaran/crew boats	2	504
Total	45	937,240

PRINTING AND PUBLISHING SERVICES IN SRI LANKA

*W.A.J. Anton Fernando**

INTRODUCTION

This paper attempts to examine the printing and pubishing sectors in Sri Lanka, and considers possible means for enhancing the competitiveness and exports of these services. Section I of the paper provides a brief account of the evolution and current state of these sectors. Section II analyses the impact of regulatory and non-regulatory barriers on the industry, with special focus on factors that adversely affect its competitiveness. Section III discusses possible government policies and other measures for strengthening the productivity of the sector and for enhancing its international competitiveness.

I. STATE OF THE INDUSTRY

The production and dissemination of books has a long history in Sri Lanka, dating back to the Polannaruwa period when the country was a centre of Buddhist learning and attracted scholars from other parts of Asia. Printing was introduced to the country in the 18th century by the Dutch, the first printed books in Sinhalese and Tamil being catechisms and readers for use in Dutch church schools. The use of printing in the country expanded in the 19th century, with the establishment of a number of new printing houses including the Government Press. The pubishing of newspapers and periodicals also goes back to this century, the Government Gazette having begun publication in 1802 and the Colombo Journal in 1832. The publication of newspapers in Sinhalese and Tamil also began in this century. The registration of newspapers with the colonial secretary was made obligatory in 1839,

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and all publications were required to register from 1885. However, data on publishing gathered from registration records are not entirely reliable, since many publications were not registered in actual practice. There has been a wider expansion of printing and publishing services in Sri Lanka in this century. This involved a better distribution of printing establishments over the whole island, the separation of the activities of the printer, publisher, typefounder, etc., as well as a steady increase in the number and circulation of newspapers in Sinhalese, Tamil and English.

In 1987, there were 1198 printing presses registered with the Government Archives. This includes 321 printing houses in the Colombo municipality area, 198 in the greater Colombo area and 670 in other parts of Sri Lanka. By 1970, the number of publications registered was 122,699. At that time there were 112 newspapers in circulation in Sri Lanka, including 46 in Sinhalese, 32 in Tamil and 32 in English.

There has been a major technological transformation in the printing industry since late 1970s. Prior to 1977, severe import restrictions imposed by the Government had limited the plant, machinery, raw materials and consumables available to the printer. As a result, the industry had been predominantly using the letter-press method. Very few large establishements had mechanical-composing equipment, while hand-composing was prevalent in other establishements. Paper was mostly supplied by the National Paper Corporation, and its quality and range were severely limited. Restrictions on the import of spare parts had made the maintenance of plants difficult. Inferior raw materials, as well as the use of obsolete machinery, adversely affected the quality of production during this period.

After the removal of many of the import restrictions in 1977, there has been a remarkable growth in the industry. While there were very few offset printing machines in Sri Lanka in 1977, their number increased to 500 in 1989, and the capacity of the sector increased tenfold during this period. This accelerated growth was facilitated by the liberal tax incentives provided by the Government in order to encourage growth and to generate employment. The industry also employed a large number of apprentices during this period for imparting training in various skills.

Most of the printing establishments now have both offset and letterpress equipment. The industry is predominantly concentrated in Colombo and the surburbs. However, there are a few good presses in the outstation Capitals such as Hand, Jaffna and Matara. Large firms are few in number. Prominent among them is the Government Press, the biggest printing press in the country. First established during the Colonial period, it has developed into one of the largest printing establishments in the world. Government publications as well as a large number of school text books are produced here annually. Approximately 8 million copies have been printed in 1989. The equipment includes 20 offset printing machines, including two two-colour MCs, 50 letter press machines including seven rotary machines, 20 lino type composing machines, 35 monotype keyboards and caster-composing units, two units of computerized type-setting systems, and a desk-top publishing system. Plate-making equipment consists of a Rachwal Paginator for plate making, and two Dainippone graphic-reproduction cameras. Binding equipment includes automatic gathering machines with side strapping facility, automatic folders, computerized guillotines and other finishing equipment. Approximately 2,500 persons are employed in the press. The annual paper consumption of the press is estimated at 7,500 tons.

Another large printing establishment is the government-owned State Printing Corporation, with an employee strength over 600. It has 18 offset Machines and concentrates on the printing of school text books (7.2 million units in 1989), information and publicity material for government organizations and job work for other State organizations. It also publishes works by new authors as well as reprints of old classics. A proposal for the privatization of the State Printing Corporation is currently under consideration. This envisages the State divesting itself from ownership by selling shares to employees. Both the Government Press and the State Printing Corporation are geared to print in Sinhalese, English and Tamil. Other large establishments include printers and publishers of newspapers and periodicals as well as commercial printers.

Most of the medium-sized establishments are equipped with offset and letterpress equipment. They usually serve the domestic commercial and industrial sectors. Some establishments are owned by

companies, while the rest are family-owned, partnership or sole-proprietor businesses. A common feature of these is the tight control exercised by owners on important aspects of the business such as purchasing, estimation and costing, and production. Most of the establishments have gone into offset production during the last decade. They still retain their older letterpress equipment in order to handle job work. A few large establishments possess mechanical type composing equipment, while some have installed electronic type composition. Firms that do not have these facilities rely on hand composition or use the services of type-setting studios. Along with the installation of offset printing machines, some presses had obtained graphic-reproduction and plate-making equipment. Others obtain the services of an outside studio for camera and plate-making work. The smaller establishments are print shops with one or two machines, managed by the owners themselves. Often these are small letterpress units having one or two machines. Presently a few offset presses also have been established. These firms rely on outside studios for their camera work and plate making. The smaller printers mostly handle commercial job work and cater to the odd printing demands of the general public.

The practice of scientific costing and estimating is rather undeveloped among the printers in Sri Lanka. While a few large and well-established firms have fairly organized procedures, most of the others rely on arbitrary methods.

Up to 1986, there were no proper training facilities for the training of personnel in the printing industry. Technical skills were obtained by apprenticing under skilled craftsmen. Managers and executives had to be trained abroad at institutions such as the London College of Printing and the Manchester Institute of Technology. During the last decade, this has become difficult due to the depreciation of the Rupee, inflation in the United Kingdom, and discriminatory charges on overseas students in the United Kingdom. An Institute of printing was set up by the printers in Sri Lanka with the assistance of the Government in order to provide training for the industry. During the past four years, the Institute has conducted courses at the technician and middle-management levels. Practical classes are conducted at the Government Press. The Institute plans to upgrade its training programmes. A full-

time training course for managers leading to a diploma in printing management is also being planned.

External block-making services have been available in Sri Lanka for some time for the use of printers. With the spread of offset printing, the need for scanning services for colour separation, camera work and plate-making services have become increasingly necessary. Premadasa, a company which had been operating a successful block-making service, has expanded its services by installing modern computerized colour separation scanners, cameras and plate-making equipment. A few other firms have entered this field, and now a relatively modernized and competitive service is available. Similarly, a number of typesetting studios which provide electronic typesetting services have entered the business during the past few years.

Traditionally, publishing has been closely linked with printing in Sri Lanka. Major publishers such as Associated Newspapers, M.D. Gunasena, Lake House Investments, and Tisara Publications are all printing companies which later branched into publishing. The largest publisher of books is the State agency, Educational Publications Department, which publishes all the text books for use in schools. This Department gets books printed by the Government Press and the State Printing Corporation. Any surplus which cannot be handled by these two organizations is given over to the private sector. Text books are distributed free of charge to school children directly through the schools. Most of the publishers tend to specialize in specific fields such as the publication of supplementary school books, novels, religious and historical works, periodicals and magazines, etc. There are also some non-governmental organizations such as the Marga Institute, Sri Lanka Foundation Institute, the Catholic Press, the Young Men's Buddhist Association, and the Sargodaya Institute which publish educational material on a non-profit basis.

II. REGULATORY AND NON-REGULATORY BARRIERS

Under the Printers' Ordinance, all printing presses are expected to register with the Department of National Archives, which maintains a register. Also printers and publishers are bound by law to deposit five copies of all books and periodicals published by them with the Department of Archives. Printers and publishers are legally prohibited from printing and publishing any obscene, scurrillous and seditious material. Also, they are liable to be prosecuted for printing and publishing any defamatory or libellous publications. During periods of emergency, the Government has the power to restrict the printing and publishing of any publication on grounds of national security, law and order. This power has been invoked and censorship imposed on a number of occasions during the last 32 years. Also, under the Press Council Law, the publishing of reports of cabinet discussions, fiscal proposals of Government, etc. are prohibited without Government approval.

A major problem faced by printers and publishers is the high cost of raw material imports. Most of the raw materials imported for the use of the industry is charged with a very high import duty and turnover tax. Import duties could range from 60 to 90 per cent of the c.i.f. value while the turn-over taxes may be as high as 15 to 20 per cent. The high import duty on paper was imposed in order to protect the local paper industry, i.e. the State-owned National Paper Corporation, which operates two factories at Valachchenai and Embilipitiya. The paper and board manufactured in these factories are of very poor quality and limited in range. Moreover, due to the use of outdated machinery and low efficiency, the cost of production tends to be high. This makes it impossible for the Corporation to compete with paper imported from abroad. As a result of the high tariffs on imported paper imposed by the Government in order to safeguard the Corporation, the industry is forced to pay high artificial prices for its main raw material.

Labour costs in the printing industry in Sri Lanka are very low in comparison with those in developed countries. Even in comparison with the costs in Hong Kong, Philippines, Singapore and Thailand, labour costs in Sri Lanka are as low as one-fifth. However, because of

the extraordinarily high cost of imported raw materials, the final cost of the printed product is more often than not higher than those in South-East Asian countries. Publishers in Sri Lanka often find that it is cheaper to get their books printed abroad, since books and periodicals do not carry any import duty when imported as finished products. Similarly, Sri Lankan exporters can get their packaging material printed abroad, import it into the country, keep it in a bonded warehouse (free of any import duty) and re-export it after packing. This can be more cost-competitive than getting the packaging material manufactured locally.

The high cost of printing is a major impediment to the development of the publishing industry, because of the difficulty in marketing publications in a limited market at a high unit-selling price. For example, a 150-page demy octavo novel printed on newsprint (the cheapest paper available) would have to be sold for about Rs. 75 (approximately two dollars). This is high in comparison to a similar publication in India. A publisher in Sri Lanka would be quite happy if he can sell 3,000 copies of a Sinhalese book on account of the small market, while in India a print run of less than 50,000 copies would be considered to be low. The high cost of printing caused by the cost of raw materials and the high unit-cost arising from the limited market available, are severe hindrances to the growth of the publishing industry.

The lack of a proper distribution system is another major difficulty faced by the industry. Publications are distributed in the country through a system of sales outlets. Some of these are bookshops, whilst the others sell books and publications along with other merchandise. Only some large firms and publishers of newspapers have their own agents outside Colombo. Other publishers have to depend on individual dealers in the outstations in order to market their publications. This has adversely affected the distribution of publications of a serious nature, as independent dealers are often reluctant to sell publications for which there is no assured demand.

It has been argued that the Government's decision to print and distribute free school text books has had a negative impact on the distribution network. Before the decision, it was the private sector that used to handle the printing, publishing and distribution of school text

books. This was a major source of income to the private sector, and part of the profit gained thereby used to be utilized for expanding and modernizing plants and for subsidizing publications of a serious or specialized nature. In 1989, the Educational Publications Department published and distributed 150 titles free to schools. The total print run exceeded 16 million copies. It is the contention of the private sector that they have been deprived of a share of this large market and, as a result, they are unable to generate sufficient funds to modernize their plants, to provide adequate training facilities to their staff, and to expand their publishing services. Publishers are reluctant to undertake the publishing of works of unknown authors, mainly because of the high investment required and the difficulties in marketing. Even if an author is able to find a publisher, he may receive very low royalties. In fact, most publishers market their publications at three times the printing costs - leaving a third to the printer, a third to the book dealer and the remaining third to the publisher, from which a very small amount is paid to the author.

III. COMPETITIVENESS AND ITS IMPROVEMENT

There are a number of factors that could help the Sri Lankan printing and publishing industry in gaining an enhanced competitive position in international markets. First among them Sri Lanka's comparative advantage in labour costs. Several developing countries have already taken advantage of their cheaper wages. For example, nearly 90 per cent of the printing done in Singapore is for export, mainly to the United States, Japan, and Western Europe, where labour costs are much higher. Sri Lanka's labour costs are far more competitive in comparison. As pointed out earlier, it is almost 20 per cent of the labour costs in South-East Asian countries such as Thailand, Singapore, Philippines and Hong Kong.

If adequate measures are taken to enhance the human resource base in terms of skills, the availability of a skilled and talented labour force could become a source of comparative advantage to Sri Lanka in the printing sector. Furthermore, managers and supervisors are reasonably skilled in the use of English language, making communication with export markets and the understanding of specifications and in-

structions easier. There is a sizeable number of managers who have been trained abroad and are knowledgeable about new developments in technology.

The present capacity of the local printing industry, if efficiently utilized, could enable the local industry to accept work from new markets without experiencing bottlenecks in the production process. Furthermore, the geographical location of Sri Lanka, with its convenient access to air and sea routes, could faciliate trade with export markets.

However the following factors seem to adversely affect competitiveness the industry:

- *Cost of imported raw material:* As mentioned earlier, the cost of raw material for printing is much higher in comparison with other countries competing for export markets. These higher material costs nullify the advantage in labour costs.

- *Higher cost of plant and machinery:* New equipment for printing in Sri Lanka costs more than in competing countries, on account of high import duties and tariffs. Printers find that the importation of new equipment in accordance with modern technology is not economically available.

- *Prohibitive cost of foreign training:* The high cost of training abroad makes it impossible for most firms to send their staff for training programmes in advanced technology. This widens the gap between domestic firms and their competitors in the international market, with respect to skills and know-how.

- *Limitations of the local market:* As the local market is small, publishers are affected by low economies of scale. Ability to enter into foreign markets, specially in relation to English and Tamil publications, would be of advantage.

- *Lack of proper communication facilities*: Recently, there has been considerable improvement in the facilities available, but further progress and modernization are required for increasing competitiveness in the export market.

- *High cost of air and sea freight:* This increases the delivery cost of bulk printed material.

- *Inadequate knowledge of international standards:* There is a lack of adequate awareness of international standards of quality control, specifications, costing and estimating. This adversely affects the preparation of quotations for international markets.

A planned strategy is needed for ensuring the development of printing and publishing in Sri Lanka. This could include State assistance by reducing tariffs on the import of raw materials, plant and equipment. By reducing import duties and turnover tax on raw material imports, the State can help the industry in reducing costs to competitive levels in relation to other print-exporting countries. At current costs, more than 60 per cent of the total cost of printing is for raw materials. If tariffs are reduced, it would be possible to reduce printing costs substantially so that the local industry is able to take better advantage of its lower labour costs. Though there are schemes for export rebates on tariffs at present, the regulations and procedures of operation of these schemes are so cumbersome that few printers actually make use of it. However, a general lowering of tariffs would make print products available to the public at reasonable costs, and this could encourage the demand for reading material. As the Government is actively pursuing a free market policy, including the privatization of State-owned industries, it could consider the privatization of the National Paper Corporation. In such an event, it will be necessary to modernize the industry so that it can work at higher efficiency and compete with imports without having the benefit of high import tariffs.

Another important aspect which has a vital bearing on the local printing and publishing industry is the decline in the demand for reading material in Sri Lanka. Tough there may be many factors including the advent of television behind this, the high cost and lack of availability of reading material seem to aggravate the problem. An improvement in the library services in the country could help in arresting this decline. In Sri Lanka, at present there are 600 public libraries maintained by the local authorities, 2,500 school libraries, 450 pirivena libraries at Buddhist temples, 150 departmental and special libraries, 8 university libraries, 30 libraries belonging to technical institutions and the National

Library in Colombo. Many of the librarries lack the provision of adequate reading material and basic facilities. The National Library has been considering a plan with State assistance to develop a provincial library service in co-operation with the newly set-up Provincial Councils. Lack of adequate funding has constrained the implementation of this plan. There is an urgent need to allocate adequate resources for the improvement of library services.

Enhancement of the international competitiveness of Sri Lankan firms in printing and publishing would require the formulation of an adequate overall strategy. This could involve measures such as:

- Assistance to export sales promotion through assistance in travel expenses for sales promotion;

- Low-interest loans and tax incentives for the purchase of plant equipment to modernize factories and to introduce new technology;

- Incentives for exporters to break into new markets;

- Sales promotion tours, fact-finding tours and exhibitions in print-buying countries;

- Promotion of visits from foreign buyers to Sri Lanka in order to make them familiar with the capacity and skills available for printing for export; and

- Seminars and training programmes for printers and publishers to diffuse awareness on the requirements of the export market, technological developments, new equipments, quality control, etc.

This work could be co-ordinated by the Export Development Board, with assistance from international agencies. There has already been some initiatives in this direction. Recently, a series of seminars and workshops have been organized by the Export Development Board, in collaboration with Sri Lanka Printers Association and with the assistance of the International Trading Centre. These training programmes addressed issues concerning procedures, costing, esti-

mation and quality control, and examined the strategies for promoting the export of domestic printing and publishing services.

Table 1

PRINTING PRESSES IN SRI LANKA - 1970

District	*No.*	*District*	*No.*
Amparai	8	Kurunegala	39
Anuradhapura	7	Mannar	3
Badulla	24	Matale	8
Batticaloa	7	Matara	28
Colombo	415	Monaragala	3
Galle	48	Nuwara Eliya	12
Hambantota	19	Polonnaruwa	6
Jaffna	62	Puttalam	20
Kalutara	55	Ratnapura	26
Kandy	65	Trincomalee	3
Kegalle	32	Vavuniya	3

Source: Administrative Reports of the Director of National Archives, Sri Lanka

TABLE 2

PUBLICATIONS REGISTERED WITH THE ARCHIVES

	1977 Titles	1977 Copies	1983 Titles	1983 Copies	1985 Titles	1985 Copies	1987 Titles	1987 Copies
Sinhala	742	4,172,688	842	8,990,215	1,022	6,715,347	1,196	11,412,682
Tamil	271	943,327	292	5,492,431	202	1,474,685	291	3,732,400
English	301	883,481	507	2,021,332	664	1,697,941	655	3,734,777
2nd Languages	114	237,304	305	298,135	332	744,298	306	666,230
Others	1	1,000	5	111,300	2	4,518	3	16,500
	1,429	6,237,800	1,951	17,713,413	2,222	10,636,789	2,496	19,562,589
	News-papers	Perio-dicals	News-papers	Perio-dicals	News-papers	Perio-dicals		
Sinhala	60	156	159	207	56	270		
Tamil	24	98	18	57	21	61		
English	23	122	22	131	21	136		
2 Languages	3	48	3	43	4	13		
Total	110	424	102	438	102	480		

Source: Administrative Reports of the Director of National Archives, Sri Lanka

ENTREPOT TRADING SERVICES IN SRI LANKA

*W.A.J. Anton Fernando**

INTRODUCTION

The word 'entrepôt' comes from French, where it means a market, a warehouse, or a store. Entrepôt trade is generally understood as the 'trade of country in the products of other countries', i.e. the importing of such products with the intention of exporting them subsequently. The Marine Encyclopaedic Dictionary (1988 edition) defines entrepôt trade as 'a transit port or bonded warehouse where imported merchandise can be stored for a time to be re-exported, without customs duty.' There are four different ways in which entrepôt trade could take place:

- Goods are imported from a second country, stored in a custom-bond warehouse and are re-exported to a third country;
- Goods are imported from a second country, imported goods undergo labelling, re-labelling or processing in the first country's custom-bonded warehouse, and they are finally re-exported;
- A trader in the first country arranges the exportation of goods directly from a second country to a third country on a back-to-back letter of credit, without the goods physically arriving in the first country; and
- A trader arranges for the transfer of consignments from one ship to another within the port, without the cargo being discharged in a bonded warehouse.

* The author is a consultant to UNCTAD.

Goods imported and cleared from the customs under normal terms after the payment of customs duty may sometimes be re-exported. These, however, do not fall within the purview of entrepôt trade.

Entrepôt trade may arise because of the price differentials caused by the different levels of tariff prevailing in various countries due to trade destrictions. It can also arise from the inability on the part of certain countries to trade with certain others. A third country could intervene, and ship the goods from one to the other.

The development of entrepôt trade in Sri Lanka may lead to the following beneficial results:

- The country could enhance its foreign-exchange earnings through the differential between import and export prices. Even though the net foreign-exchange earnings may appear to be low in percentage terms, it could be very high in absolute terms if the turnover is high. However, sometimes it could be high even in percentage terms, since the mark-ups could be as high as 40-50 per cent;
- The development of this sector would generate more employment, both direct and indirect;
- Payment for services provided in connection with entrepôt trade will facilitate increased earnings by ports, airports and allied public sector and private sector agencies;
- Sri Lanka's export possibilities can be further developed, taking advantage of the break-bulk facilities and the opportunity to use a new range of imports; and
- Sri Lanka could, to some extent, be competitive with neighbouring ports and airports and could recover part of the costs incurred in modernizing cargo-handling facilities.

I. STATE OF ENTREPOT TRADE IN SRI LANKA

At present there are only a small number of firms who are engaged in entrepôt trade in Sri Lanka. The export turnover of these firms was estimated at approximately Rs 200 million in 1989. The details of entrepôt trade engaged in by these firms are as follows:

(in million rupees)

		1989	1990 (Projections)
1.	IDAC Trading (Pvt.) Ltd.	183.0	n.a
2.	Pee Bee (Expo) Ltd.	20.0	40.0
3.	Kiripak Lanka (Pvt.) Ltd.	6.8	8.0
4.	Akbar Bros.	n.a	0.2

The products traded by these firms include paper, plastics, liquor, cigarettes, milk powder and coffee.

The lack of development of entrepôt trade in Sri Lanka can be attributed to the following factors:

- Lack of awareness among Sri Lankan exporters and businessmen of the possibilities of trade in this sector;
- A number of Government policies and procedures which function as barriers to the development of entrepôt trade;
- Lack of adequate incentives for engaging in entrepôt trade; and
- Lack of reliable data, as the customs do not report entrepôt trade as a category.

There are several factors that could enable Sri Lanka to establish a competitive position in entrepôt trade. They include the country's strategically significant geographical location in relation to world shipping routes and time zones, the low port charges levied in Sri Lanka for inbound and outbound cargo, the modernized facilities available in Colombo harbour, and the low costs of warehousing and wages.

II. REGULATORY AND NON-REGULATORY BARRIERS

In this section, I shall examine a number of factors that currently constrain the expansion of entrepôt trade in Sri Lanka and consider what specific policy measures can lead to their removal.

A. Inadequacy of incentives

Incentives need to be more specifically targeted to motivate entrepôt trade. Even though a number of fiscal incentives already exist, they have to be reformulated to suit the actual needs of the sector. Profits from entrepôt trade in respect of products approved by the Minister of Finance are exempt from taxation under section 15 (p) of the Inland Revenue Act of 1979, which reads as follows:

> profits and income arising in Sri Lanka, to the consignor or consignee, from the export, on or after November 15, 1979, of -
>
> (i) any precious stones or metals not mined in Sri Lanka;
>
> (ii) any petroleum, gas or petroleum product; or
>
> (iii) such other products as may be approved by the Minister for the purposes of this paragraph having regard to the foreign exchange benefits that are likely to accrue to the country from the export of such products;
>
> being stones, metals, petroleum, gas or products, as the case may be, brought to Sri Lanka on a consignment basis, and re-exported, without subjecting such stones, metals, petroleum, gas or products, as the case may be to any process or manufacture.

The products that qualify for exemption from taxation are at present limited to precious stones, metals, petroleum, gas, or other products approved by the Minister. This restriction seems to act as a barrier to the expansion of entrepôt trade to include a larger variety of products. An amendment of this section of the Act in order to include all products, except restricted or prohibited products, could greatly facilitate the development of this sector. Secondly, according to the present legislation, products have to be brought to Sri Lanka and be re-shipped without processing. This seriously restricts the scope of

entrepôt trade. The law, therefore, has to be amended to allow for goods to be traded without being brought to Sri Lanka and to allow for any processing. This would enable traders to engage in offshore trade.

Sub-section (s) of section 15 provides for the exemption of profits of the business operations related to entrepôt trade, such as warehousing. This sub-section reads as follows:

> . . . the profits and income arising to any person from an undertaking approved by the minister for the operation and maintenance of facilities for the storage of goods or commodities brought into Sri Lanka for re-export.

Exemption of dividends from payment of income tax, investment relief and accelerated depreciation are also available to enterprises engaged in entrepôt trade, if they are approved by the Minister for the purpose of section 15, stated earlier. If the goods are not cleared from the harbour and are consigned to a bonded warehouse inside the harbour, there is no payment of duty and turnover tax on imports. If the goods are consigned to a bond outside the harbour, a nine-tenths drawback of duties and turnover tax is available.

Credit under the supplementary refinancing scheme of the Central Bank at concessionary terms is available on the production of letters of credit, or on evidence of confirmed orders. However, if the amounts involved are large, the situation could change and entrepôt trade will have to resort to high-cost financing, as this particular refinancing scheme is intended for small exporters.

The main assistance schemes under the Export Development Board (EDB) have not been specifically targeted towards entrepôt trade, as a minimum foreign-exchange earning capacity is specified. For instance, the Export Development and Investment Support Scheme (ESISS) is applicable only to sectors where the net foreign-exchange earning capacity is above 20 per cent. In the case of equity participation too, a net foreign exchange earning capacity of over 20 per cent is insisted on. Assistance to expand exports in the short-term is available only to manufacturing and processing exporters. Here, the net foreign-exchange earning capacity should not be less than 30 per cent. There is, however, a gradual phasing-out of such subsidies and tax incentives.

B. Inadequacy of warehousing facilities

There is inadequate space for goods involved in entrepôt trade, both at the ports of Colombo and Galle, and at the Katunayake airport. There are three bonded warehouses in the Port of Colombo, with about 27,000 sq.ft. and a new warehouse with about 18,000 sq.ft. of space is to be constructed shortly. It is recommended that one of these warehouses should be set apart specially for entrepôt trade, as it would then be possible for entrepôt traders to undertake some processing as well, within the warehouses. At the moment, the warehouse that is made available to entrepôt traders is also used by others, e.g. by those who do not wish to pay duties immediately.

The Galle harbour has two bonded warehouses with about 60,000 sq.ft. of space. About 40,000 sq.ft. is being used by a private company. The airport has no bonding space. The Ports Authority and the Airports Authority need to take appropriate action to provide for adequate space as well as the allied facilities. The Air Cargo Village (ACV) set up recently at the Colombo International Airport is a step in the right direction.

The feasibility of establishment of yards and warehousing facilities close to the port should be examined by the Ports Authority and the Airports Authority, in collaboration with the Urban Development Authority (UDA). The possibility of attracting the private sector in this connection should also be considered as tax incentives are available for such business.

C. Cumbersome regulations and procedures

Some of the exchange-control procedures may not be appropriate for entrepôt trade. One of them is the requirement to establish a back-to-back letter of credit for each consignment of goods within a specified period. However, the exporter would need to be able to hold the goods in stock for sometime, in order to secure higher prices. It is also possible that some of the suppliers may be ready to send goods on credit. The Exchange Control Department should therefore consider

doing away with the requirements of establishing back-to-back letters of credit.

Existing exchange-control regulations require that goods should physically arrive in Sri Lanka before re-exportation, thus effectively ruling out the possibility of off shore trade. The Exchange Control Department should consider amending this regulation to enable an exporter in Sri Lanka to ship goods direct from a second country to a third.

The Exchange Control Department also requires entrepôt traders to obtain a licence from the Central Bank to export goods from Sri Lanka. This function should be delegated to the commercial banks.

One of the recent Central Bank requirements specifies that entrepôt traders should deposit a 100 per cent cash margin when opening an import letter of credit. This practice compels the exporter to borrow funds from banks at interest rates ranging from 24-26 per cent. Such costs could erode the profit margins arising from entrepôt trade. Entrepôt traders have suggested that they should be allowed to open letters of credit on a nil margin since the goods are ultimately for export. Furthermore, at present the banks charge a stamp duty of 3 per cent. They suggest that banks be instructed to charge stamp duty at the concessionary rate of -/50 cts. per Rs 1000, since the goods imported are ultimately for re-export.

The Sri Lanka Customs Department has recently done away with certain requirements such as producing bank guarantees. However, they still insist on landing certificates which causes problems to entrepôt traders, as some countries delay the issue of such landing certificates. Therefore, the Customs could consider doing away with this requirement.

While on the subject of the Customs Department it is pertinent to mention that perhaps one of the biggest constraints to development of entrepôt trade is the cumbersome procedures, documentation and practices associated with imports and exports. The present customs law has to be brought in line with that of Singapore or Dubai, to substantially reduce procedures and documentation, and to avoid practices which restrict the free flow of trade.

The system of valuation of goods, adopted by the Customs Department also poses problems for the entrepôt trader. It is reported that if the price of goods imported is too low, it is considered as undervalued and confiscated forthwith. Entrepôt traders argue that this prevents the import of goods at the most competitive price.

The Ports Authority has brought down the rate in the case of cargo bonded for entrepôt trade purposes to a reasonable level. However, it requires all entrepôt traders to make a deposit at the rate of Rs 25 per carton. The entrepôt traders invariably clear the goods within a matter of days. However, the deposit is not refunded immediately. It is reported that sometimes it takes two years for a refund to take place. This is an additional cost that entrepôt traders have to incur, and a cost that erodes their margins of profit. Bank guarantees could be accepted instead of this deposit.

D. Lack of information and awareness

One of the major constraints is the lack of information on entrepôt trading opportunities. The EDB and the Trade and Shipping Information Services (TSIS) may have to provide this information. Assistance could also be given for entrepôt traders to attend symposia and relevant fairs, to develop contacts and obtain information. In addition, agencies like the Export Development Board may carry out market development studies to identify opportunities for entrepôt trade. The Chambers of Commerce as well as relevant government agencies could play a very important role in disseminating information on entrepôt trade through the conduct of seminars, etc. among traders. Information on Government policies for the development of the sector as well as the specific incentives available could be effectively diffused through these seminars.

III. LINKAGES WITH OTHER SERVICES

Although entrepôt trade is really a form of trade in commodities, it relies on the supply of a number of services such as transport, freight, banking, insurance, etc. Consequently, the development of this sector depends on the adequate supply of the supporting services and on a strategy that recognizes the linkages among them.

The Export Development Board of Sri Lanka has identified five service sectors for priority attention in the National Export Development Plan for the period 1990-94. They are the following:

- Professional services;
- Construction services;
- Film industry;
- Conventions; and
- Port transportation and insurance.

Port transportation and insurance comprise a wide range of services including safe berthing of ships, ship repairs, warehousing, and the related financial services such as banking and insurance. This sector is at present the principal segment on earnings from services in the national economy of Sri Lanka (see Table 1). Sri Lanka earned SDR 92 million in 1988 from this subsector, and national accounts show a continuous increase in earnings.

At present, Colombo sea port and its hinterland are adequately organized for large-scale container handling, warehousing, and break-bulk cargo handling, with dry dock facilities for export and import of goods. Facilities are also available for repair and maintenance services for ships-in-wait and dry-dock installations. Over the past years, infrastructure facilities such as warehousing and storage, supported by adequate handling equipment, have developed to a remarkable extent in Colombo port, involving considerable investment. The Katunayake International Airport is re-developed to provide modern facilities to handle passengers and cargo. Infrastructure facilities developed offer a wide range of opportunities including information services and industrial processing. Other ports in Sri Lanka such as those at Jaffna, Trincomalee and Galle also have the potential for development for cargo handling. The development of these ports can enable Sri Lanka to service the entirety of Indian Ocean countries. Sri Lankan ports can be further developed to handle re-export services, entrepôt trade and container break-cargo facilities.

Although the Sri Lankan sea ports and airports have developed considerably over the past years, a strategy for enhancing service activities in the country would require a strengthening of infrastructure facilities. This includes additional berthing facilities, warehousing, modern mechanical handling, etc. The effective use of ports will greatly depend on operational procedures which requires greater improvement. Working hours, handling systems, storage and movement of cargo - all these need to be developed further to attain increased efficiency in terms of time and quality of service.

The development of entrepôt trade will, to a great extent, depend on the various services provided by sea and airports. In international ports, cargo and passage clearance is controlled by rules relating to port administration and customs regulations. Therefore, an effective harmony between the two is vital for ports to be efficient in serving customer interests. Customs bonded warehouses are inadequate to facilitate inward processing activities and re-export trade. Container freight stations are not equipped with customs offices, thereby causing procedural delays in handling cargo.

Physical insfrastructure for the supply of services under this subsector is only moderately developed at present. However, the actual performance will depend on the contribution of different policies relating to shipping, aviation, insurance, national preferences and policies regarding foreign direct investments in these fields. Hence the need for an outward-looking policy to service the needs of international shipping lines, airlines and trading interests to enhance earnings from this sector.

It might, however, indirectly benefit entrepôt trade if restrictions on the provision of services such as transport, sea and air freight, banking and insurance are provided at competitive rates and free of restrictions. Restrictions such as monopolistic controls in the way of the provision of such services should therefore be identified and removed.

IV. CONCLUSION

To summarize, Sri Lanka has the potential for developing an internationally competitive position in entrepôt trade. However, this potential needs to be identified in specific terms, and adequate policies

need to be formulated in relation to them. Such policies would involve the removal of a number of existing Government regulations and bureaucratic procedures. There is a great need to facilitate the flow of trade by simplifying customs, exchange control, ports and airports procedures. Furthermore, adequate financial incentives need to be made available to firms engaging in entrepôt trade, especially in the initial stages of development. Information on the possibilities of trade in this sector needs to be made widely available to the trading community. Finally, an overall strategy would need to be formulated, taking into account the linkages that exist between port services, financial services and entrepôt trade.

TABLE 1

EARNINGS FROM SERVICES

	Rs. Mn.					*SDR Mn.*		
	1984	*1985*	*1986*	*1987*	*1988*	*1985*	*1986*	*1987*
Port transportation and insurance	1,811	2,016	2,760	3,406	3,898	73	84	89
Travel	-	2,233	2,326	2,107	1,964	81	71	55
Investment income	1,479	2,261	1,893	2,055	2,180	82	58	53
- Profits and dividends	1	5	15	8	[illegible]	-	-	-
- Interest	1,478	2,256	1,878	2,047	2,171	82	58	53
Government expenditure	304	310	383	609	715	11	12	16
Miscellaneous	2,386	2,106	3,239	3,584	3,767	76	98	94

Source: Central Bank.

SERVICE SECTOR AND TRADE IN SERVICES IN CHINA

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INTRODUCTION

This paper is a preliminary attempt to initiate further work on issues related to production and trade in the service sector. The message this study conveys is that the Chinese economy has paid a high price for the long neglect of the importance of the service sector. The bias towards heavy industry has been one of the major causes for disequilibrium in the economy and, consequently, for several periods of painful economic adjustment. However, in each attempt at adjustment, emphasis was given to the redeployment of agriculture, light industry and heavy industry. The service sector was never given adequate attention. The neglect of the sector has resulted in an immense waste of resources as well as in loss of time for economic construction. The backward state of the service sector represents a sharp contrast to the industrial sector.

The second message this paper intends to convey is that the world economy is undergoing a drastic change in the pattern of production and trade, and that the Uruguay Round negotiations on trade in services will substantially alter international rules. This, in its turn, will have a great impact on the success or failure of China's open policy and economic reform. Therefore, careful planning is needed for elaborating an appropriate international economic strategy that would really help China to make substantial gains through the internationalization of its service sector. This brief study cannot, of necessity, fulfil this task in its entirety.

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I. GENERAL TRENDS IN THE SERVICE SECTOR

At the outset, it is important to point out the statistical and definitional problems in undertaking a study of services in China. China began to compile statistics on the tertiary industry on the basis of the statistical methods of the United Nations and the World Bank only in 1985. As a result, it is unrealistic at this stage to expect accuracy in such statistics. As far as definition is concerned, primary industry includes agriculture, forestry, animal husbandry and fisheries. The secondary industry covers manufacturing and construction, and the tertiary industry covers all other economic activities. In this paper, the definition of the tertiary industry is taken to mean the service sector.

In the 1950s, the Chinese economy was very backward, and the service sector was very small in size and irrationally deployed. In 1952, the output accounted for 28.7 per cent of the gross national product (GNP). The ratio rose to 30.2 per cent by the end of the first five-year plan (1958). During the twenty years from 1958 to 1978, economic thinking was seriously biased towards the manufacturing industry, particularly towards the heavy industry. This bias stemmed from a conceptual error which regarded services as non-productive. In this period, China adopted the method of categorizing the economic sectors into material production sector and non-material production sector. Most of the services fell, according to this classification, into the latter category.

Services were considered essentially as the redistribution of wealth created by material production units. Consequently, low priority was given to this sector in investment. By 1978, the share of the service sector in the GNP declined to 23 per cent, that of the secondary industry rose to 48.6 per cent, and that of the primary industry dropped to 28.4 per cent.

It was only during the period of open policy that the service sector received increased attention. This was the result of a fundamental change in economic strategy which recognized intellectual work as creating wealth. This period saw the rehabilitation of traditional services as well as the development of new services. The GNP ratio rose

from the lowest point of 20.0 percent in 1979 to 25.7 per cent in 1988. The population engaged in services increased from 53.44 million, accounting for 12.6 per cent of gainful jobs in 1980, to 97.31 million, accounting for 17.9 per cent in 1988.

In spite of rapid expansion of the service sector in the past decade, services have continued to be in short supply in China, as the manufacturing industry outgrew the service sector. In certain specific services, which are of vital importance to the national economy, the supply-demand gap has actually widened. Even though the growth might appear impressive in absolute terms, the service sector remains a bottleneck, frustrating the balanced development of the national economy.

The problem is particularly acute in transportation, post and telecommunications, informatics, commerce, finance, insurance and technical services. The shortage of supply presents a major constraint on the national economy. Some of the major features of underdevelopment are as follows:

Extremely low level of development in international terms. For example, in 1985, the average ratios of the tertiary, secondary and primary industry to the GNP were 63 per cent, 34 per cent and 3 per cent respectively for developed countries. For middle-income countries, the ratios were 44 per cent, 33 per cent and 23 per cent. For China, the ratios were 25 per cent, 46 per cent and 29 per cent respectively. The service ratio was much lower than that of India (42 per cent), even lower than those of Ethiopia and Bangladesh. In terms of employment pattern, statistics for 1983 shows that average employment in the tertiary industry was about 56 per cent for developed countries, 28 per cent for the low-income countries, and 13.8 per cent for China. This sector plays only a minor role in absorbing the labour force shedded by the agricultural sector and created by natural population growth, amounting to approximately 15 million persons each year.

Acute shortage in the production-supportive services of transportation, post and telecommunications consitutes a major bottleneck constraining the growth of aggregate social supply. The transportation capacity lagged far behind the need of national economic development. The situation was exacerbated by the dispersed deployment of raw

materials production and processing industries. In 1987, the output of railway passenger transportation was 284.3 billion man/km, equivalent to that of India, cargo transportation output was 947.2 billion ton/km, about one fourth of that of the Soviet Union. It is estimated that the railway capacity is 30 per cent short of the need of the national economy.

Ocean cargo shipping was 80.73 million ton, about 50 per cent of that of Indonesia or one third of Australia. Passenger air transportation output was 187 billion man/km, air cargo transportation was 650 million km/ton, approaching the level of India. China's total length of highway is about one million km. That is one km per 1,000 people. For India it is 2.2 km per 1000 people and for the Soviet Union 3.5 km per 1,000 people.

Post and telecommunications remained a low-growth sector for a long period of time. The telecommunication network has a low area coverage and low density. For example, the total number of telephones in China forms only 0.8 per cent of the world total. In 1988, every hundred people possessed 0.86 phone on average. The extrapolation of the multiplier effect of the post and telecommunications sector reveals that every yuan invested in telecommunication will produce social wealth of 3.5 yuan. However, investment in this sector remained at a low level for a long time, and this has caused serious damage to the development of the national economy. Thirdly, generic deficiency in commercial services, informatics, financial and insurance services, characterized by planned economy, obstruct the process of specialization of production. The lack of wholesale services increases the need of running capital and reduces the efficiency of capital utilization. Working capital locks up 57 per cent of total capital in comparison with the average ratio of 15 per cent in other countries. Information services are scarce and are generally provided not by specialized providers, but by in-house service providers. This situation constitutes a barrier to the socialization and specialization of services and to taking advantage of economies of scale.

In conclusion, the general level of development of the Chinese service sector lags behind that of the developed countries and the average of the developing countries. The underdevelopment of the service sector is attributable to the following factors.

Due to the conceptual bias in favour of the material production sector at the expense of the non-material production sector, investment in services has been kept a low level. The fundamental shift away from the traditional economic strategy towards a more outward-looking policy has recognized the importance of the service sector. However, problems posed by lack of investment remain unresolved due to structural constraints. The State price structure of services does not adequately compensate for the value of services provided. The cost of investment is borne by the service producers while benefit is conferred on the national economy as a whole. The cost is immediate and the benefit to society will only be seen in the longer term and in a dispersed manner. The service producer can hardly generate accumulated capital for reinvestment.

In the Chinese service structure, there are three sources of compensation, viz. higher prices set by the State, tax incentives and governmental subsidies. In spite of the partial adjustment of services charges made in the last few years, a comprehensive price system in services would be possible only in the context of economy-wide price reform, particularly a radical change of the low-pay system of income distribution. The major sources of investment come from government-allocated funds and subsidies. The Government has already been burdened with a heavy welfare subsidization programme in respect of housing, medical care, public utilities, education, transportation, and post and telecommunications. Substantial increase in government subsidies would prove to be quite difficult.

Non-specialization and non-commercialization of services has cuased distortion in the production and consumption pattern. The self-sufficiency system of service production and utilization represents a primitive economic approach. All enterprises have to equip themselves to provide in-house services such as accountancy, designing, repair, data processing, advertising, market research, transportation and warehousing. The services are produced inefficiently and the production facilities are utilized inefficiently. It precludes the possibility of taking advantage of economies of scale.

There is an urgent need of rapid development in this sector. However, the expansion of the sector has to be kept in pace with the

general level of social and economic development and with the balanced development of various sectors in the economy. Almost 60 per cent of the population rely on the primary sector for their living. The stable development of agriculture is the basis for national political, economic and social stability. Investment in the agricultural sector needs to be increased. Industrialization and the development of an export-oriented sector will mainly focus on manufacturing, particulalry the labour-intensive manufacturing industries, taking into account the international comparative advantage. While major efforts will be made to solve the problem of bottleneck, the development of the service sector would need to be accelerated. The average annual growth rate of the Chinese economy in the remaining years of this century is envisaged to be around 5.4 per cent, and the development of the service sector as a whole will be within this parameter. This is the basic factor to be taken into full account in the negotiations of mutual concessions on trade in services.

II. THE STATE OF TRADE IN SERVICES

As the service sector in China remains at a low level of development, trade in services in the country is very small, representing only one per cent of world's total service exports. According to IMF's *Balance-of-Payments Statistics 1984*, the total value of China's trade in services was $7.493 billion, of which exports were $4.819 billion and imports $2.674 billion. In 1989, the total trade increased to $12.1 billion, of which exports accounted for $6.8 billion, and imports for $5.3 billion. The ratio of export value to the gross tertiary industry output for 1984 and 1989 were 13.8 per cent and 12.5 per cent, accounting for 3 per cent and 2.8 per cent respectively of the gross national product. In other words, the relative importance of services exports was on a decline. The comparable figure for merchandise exports increased from 8.3 per cent in 1984 to 12.5 per cent in 1989.

There is an uneven development of trade in different service sectors. Fast growth has taken place in some subsectors such as tourism, ocean shipping, and engineering and construction, while growth in other subsectors has been slow. Tourism is a fast-growth sector, having multiplier effects on a number of economic activities, particularly air

transportation, hotel construction and catering services. It involves comparatively small investment and produces quick results, high economic return and employment opportunity. The growth of this sector is closely related to the open policy and the increased international economic relations. China's long tradition of ancient culture and civilization represents a great attraction for foreign tourists. In 1980, shortly after the adoption of the open policy, China received 5.7 million overseas tourists, thereby earning $617 million. The figures rose to 31.7 billion people and $2.25 billion in 1988.

The growth of tourism has brought about a fast expansion of civil aviation services, with air traffic lines increasing from 188 in 1978 to 350 in 1988, with a total length of traffic of 650,000 km, of which 48 are international lines of 250,000 km extending to 34 cities of 26 countries. At present, passenger transportation reaches 14.42 million persons, an increase of 5.2 times as compared with that of 1978, representing an annual growth of 20.2 per cent. Total cargo transports rose by 6.7 times, amounting to 2.312 billion ton/km. In 1988, air services earned an equivalent of 5670 million yuans (RMB) of which $750 million are in foreign exchage.

III. THE BANKING AND FINANCING SECTOR

Financial services have acquired a new look since the adoption of the open policy and economic reform. Until the beginning of the economic reform in 1979, banking institutions had played the role of the accounting and cash department for the Ministry of Finance. In line with the general economic reform, a progressive process of banking and financing reform has been implemented. This reform consists of the following aspects:

Reform the banking system: Decentralization of management power by reinstituting the Agricultural Bank of China, separating the Bank of China from the People's Bank of China (the Central Bank) as a specialized foreign exchange bank, establishing the Industrial and Commercial Bank of China as well as the Construction Bank of China. The Communication Bank of China was reinstituted in 1986 as the first share-holding bank. In the special economic zones of Guangdong and

Fujian, a number of development banks were established. In the special economic zones and in Shanghai a number of foreign-owned banks and joint-venture banks were established. Thus, the highly centralized banking and financing system has been turned into a diversified system consisting of comprehensive banks, regional banks, specialized banks, foreign-owned banks, joint-venture banks and other financing institutions.

Expanding the scope of banking operations: Departing from the past practice of providing only short-term credits, banks start to extend medium and long-term credits for capital goods purchases. This is in consonance with the financing system reform in which free use of State-allocated funds by enterprises has been replaced by a system of loans and credits with interest charges in order to push the enterprises to increase efficiency. The banking institutions have an important role to play in project financing. During the period from 1979 to 1981, 82 per cent of the newly increased working capital came from bank loans and credits.

The permission of bank-to-bank lending and borrowing in order to utilize available funds more efficiently.

The introduction of various forms of credits, financing and fund-raising, e.g. the issuing of shares and securities.

Reform of the exchange-control system: This comprises three main elements: (a) a foreign exchange quota account system allowing enterprises to keep their allocated and retained foreign exchange in their bank account, (b) retention of a certain percentage of export earning by enterprises and local governments, and (c) the creation of foreign exchange swap centres to allow free transaction of foreign exchange among enterprises.

In keeping pace with the general open policy and economic reform, China began to implement a partial, progressive liberalization of the banking and finance sector. This began in 1985, with the promulgation of the "Rules and Regulations concerning the Administration of Foreign Banks and Joint-Venture Banks in the Special Economic Zones", providing for the possible establishment of foreign banks and joint-venture banks. The regulation set the following scope of ac-

tivities for such banks: (a) the extension of credits in RMB and foreign currencies and discount of securities and bonds; (b) foreign exchange acceptance; (c) settlement of export payments; (d) cashing of bills in foreign currencies; (e) investment operation in Chinese and foreign currency; (f) guarantee operation; (g) shares and security transactions; (h) foreign-exchange transfer; (i) settlement of import payment and (j) foreign-exchange deposits. Up to now, 22 foreign-bank branches, joint-venture banks and wholly-owned foreign banks have been established in the special economic zones. In Shenzhen, 30 per cent of the payments have been settled by foreign banks. In the interior, foreign banks are allowed to set representative offices or liason offices. At present, there are 190 such offices set up by 110 foreign banks in 13 major cities in China.

These are the initial actions China has taken in liberalizing the banking and financing sector. However, these measures apply only in the special economic zones. In the interior, banking and financing business is still restricted to national entities. A full liberalization of this sector cannot be possible in the immediate future.

IV. THE STATE OF THE INSURANCE BUSINESS

The State-owned People's Insurance Company, established in 1949, played an active role in taking over the insurance business which had been controlled by foreign capital. The sector had shown stable development until 1958. However, during the period from 1958 to 1979, the domestic insurance business was suspended as a result of the negative conception of services as non-productive. The economic reform underlined a fundamental change in economic conception. There has been an increasing recognition of the role of services in the national economy. The domestic insurance business was resumed and was able to grow by some 50 per cent each year. Income from insurance premium increased from RMB.1.45 billion in 1983 to RMB.14.24 billion in 1989, showing a ten-fold growth in five years.

Insurance institutions increased to nearly 30,000 with a staff of about 100,000 people. The domestic business covers more than 300 types of insurance, and external operation covers more than 80 types

of insurance. While domestic business has expanded rapidly, external operation has remained stagnant due to the captive nature of the foreign market and to the lack of efficiency of domestic insurance institutions.

The export of insurance business could be classified into the following six categories:

(1) *Foreign-related insurance:* This category covers all risk underwriting by the People's Insurance Company for foreign institutions, enterprises established, or foreign nationals residing in China. With the rapid increase of in-coming foreign investments, the business has been expanding rather quickly. The Company can provide services in virtually all risks available in the international market.

(2) *Overseas operation:* This relies mainly on Hong Kong business and overseas Chinese in other parts of the world. The business increases by about 10 per cent annually. There are 9 subsidiary companies and 45 sub-branches operating outside the mainland.

(3) *Marine cargo insurance:* It relates to insurance against marine risks for export products. It accounts for the major part of the foreign-related insurance business and the major source of foreign-exchange earning. The rapid expansion of foreign trade provides great potentials for further development of this category of insurance.

(4) *Inward reinsurance:* This involves mutual sharing of foreign-exchange payment in exchange for outward reinsurance.

(5) *Reinsurance by overseas offices:* Given the complexity and market-access difficulties, the operation is at a very limited scale.

(6) *Agency business:* The People's Insurance Company and its subsidiaries or branches act as agents to handle business on behalf of foreign insurance companies for settlement of claims, surveys and recoveries, issue policies, etc. At present these services generate a foreign-exchange income of about $2 million. In anticipation of growing international economic relations, this business is expected to grow substantially.

China has no direct imports of insurance services. Chinese law does not grant right of establishment to foreign insurance companies. Assets and properties in China are not allowed to be insured in foreign countries. However, China pays a considerable amout of trade-related insurance premiums on the basis of c.i.f. import prices. Approximately, 30 per cent of the import trade insured in foreign countries in the form of c.i.f. values.

Another form of indirect import of insurance services relates to outward reinsurance of risks involving transactions insured in foreign currencies such as aviation insurance, hull insurance, insurance on marine cargo transportation, oil exploitation, contractor's all risks, erection all risks, product liability risks, etc. As China has limited availability to foreign exchange, the People's Insurance Company has to assign a certain proportion of its liabilities to foreign insurance companies and at the same time pay an equivalent proportion of premiums.

The insurance business in China is expected to have a robust growth prospect, along with the healthy development of the national economy and social welfare. For example, the substantial increase in disposable personal income level and the development of social security programme provide for great potential of development of life insurance and property insurance. A wide range of insurance such as fire insurance, crop insurance and motor vehicle insurance will develop substantially in line with increased economic activities, particularly in view of economic reforms which make enterprises accountable for their profits and losses including all kinds of risks.

Given the captive nature of the international insurance market and the lack of development resulting from the 20 year suspension of domestic insurance, the Chinese insurance industry will primarily look to the domestic market for growth, and build up its strength through economies of scale in the domestic market. Trade-related insurance business will keep pace with the development of foreign trade. Moreover, the Chinese insurance sector lacks powerful financial backing and the necessary expertise for expansion in international markets. Apparently, it will have little to gain from liberalizing the domestic market.

V. TOURISM AND HOTEL SERVICES

Tourism and hotel services constitute a newly developed economic sector having linkage effects spreading over a wide range of economic activities such as transportation, telecommunications, commerce, finance and insurance, catering, food processing, construction and engineering, etc. The development of China's tourism industry is closely related with the open policy begun in 1978. Tourism is increasingly being recognized as an important economic sector incorporated in the national programme of economic and social development. The past ten years have witnessed rapid expansion in this sector. Various tourist organizations were established, and several tourist hotels have been built during this period. Twenty international group enterprises from nine countries and regions have come to China in order to build and operate tourist hotels in 43 cities in the country. Foreign capital has taken an active role in the construction of tourist hotels. In 1987, foreign capital participated in 90 construction projects, and the financing amounted to 1,270 million. The comparable figure for 1988 was 86 projects involving $368.97 million, and for 1989, 33 projects with $239.9 million.

The development of tourism has promoted a wide range of tourism-related activies. There are five major enterprise groups dealing with tourist products. They are the following:

- The China Tourist Service Corporation - established 35 local branches in different parts of the country;
- The China Friendship Store Group - has 63 local branches;
- The China Arts and Craft Corporation - has 54 local branches;
- The Duty-Free Shops Group - has 56 subsidiary shops; and
- The Overseas Chinese Service Corporation Group - has 24 local branches and 14 duty-free shops.

There are 73 tourist transport corporations with a convoy of 31,052 tourist vehicles, and 165 tourist boats and ships. Tourist institutions and direct tourism services provide 438,987 jobs.

During the period of economic reform, the tourism industry showed impressive development. In 1988, incoming travellers increased to 31.69 million, 17.6 times of that of 1978 - an average annual increase of 33 per cent. In the same year, foreign-exchange earnings increased by 8.6 times (compared with 1978) to \$2.246 billion. Accumulated foreign-exchange earnings during the ten years (1978-1988) amounted to \$11.92 billion, making tourism one of the major sources of foreign-exchange earning.

Finally, domestic travel by Chinese citizens also showed substantial growth in this period. With the improvement in living standards and fast-growing business activities, tourist and business travels reached 300 million person/time in 1988 generating an income of RMB 8.7 billion. The infrastructure can hardly cope with this fast growth.

As mentioned above, the development of tourism has multiplier effects on a wide range of economic activities. China has planned to make further efforts in order to expand its tourist industry. For a long time to come, China will principally be a supplier of tourist services. As a result of foreign-exchange shortage and low living standards, the Chinese cannot afford tourist services from abroad. China would generally like to keep the domestic market for its national suppliers. However, it is still a subject for debate whether allowing foreign tourist operaters to work in China will actually bring in more tourists and create greater opportunities for Chinese operators.

VI. CONSTRUCTION AND LABOUR SERVICES

As a large country, China has a large construction and engineering contingent. The statistics for 1988 show that China has a total number of 87,224 construction enterprises, employing 18,994 million people. Total annual output for the same year was RMB 77.7 billion (\$16.5 billion). The large domestic construction market provides a good basis for achieving economies of scale. The large construction work force is an advantage which China can use in order to expand foreign business. However, before the economic reform, contracting for foreign construction projects was almost non-existent. Efforts to develop international contracting began in 1979. With experience drawn

from foreign economic assistance projects extended to developing countries, Chinese construction enterprises have been able to develop their international operations rather quickly. In 1988, according to the State Statistical Bureau, there were 2,126 construction and labour services contracts with a total value of $1.43 billion, an average annual increase of 15 per cent showing since 1979. The aggregate contracted value for the ten year period was $10.5 billion with actual implementation of $6.0 billion.

Overseas contracting and labour service operations began with low technological projects such as housing and highway building and gradually extended to more sophisticated complete plants such as steel plants, chemical fertilizer plants, large power stations, dams, marine tugging, harbour designing, light industry, textile, coal, geology, petroleum, machinery, forestry, and communication satellite launching. Chinese contracting and labour-service enterprises are also exploring the possibility of extending co-operation with East European countries and the Soviet Union.

In consultation, a new sector of construction and labour services is emerging in Chinese economy. However, further expansion of the sector in the international market will depend on a number of factors - particularly, the market-access situation.

VII. POLICY ISSUES

China's primary concern in respect of the service sector lies in ameliorating the underdevelopment of the services infrastructure which constitutes a bottleneck, frustrating the balanced development of the national economy. While the policy biases against the service sector have, by and large, been overcome, systemic problems still remain. The economy lacks an automatic mechanism that would enable service operators to accumulate their own investment funds. A pricing system with welfare considerations as its top priority can hinder efforts to resolve the under-investment problem. Under the existing low-pay system, an abrupt price liberalization of services seems to be unrealistic. Economists have suggested that progressive commercialization and specialization of services would help to alleviate the present impasse. As the infrastructure shortage is a system-wide issue requiring enormous

investment, the limited governmental investments will need to focus on the most important subsectors such as transport, telecommunications, commerce, finance and insurance, and consumer services. For some particular service subsectors, it might be possible to seek expansion through internationalization. In brief, the development of the service sector will be a major concern for China. This has to be adequately recognized in the Uruguay Round negotiations on trade in services.

The data presented in this paper shows that the solution of the problem of underdevelopment in the service infrastructure requires not only a conceptual recognition of the important role that the service sector plays in the national economy, but also a structural reform to allow service enterprises to accumulate investment funds. This is particularly relevant as an open Chinese economy would need to brace the storm of rapid change in the world pattern of production and trade, resulting particularly from the Uruguay Round of multilateral trade negotiations. An eventual multilateral framework on trade in services will definitely have a major impact on China's service sector. A comprehensive analysis of the service sector is required in order to develop appropriate policies. Such a study will need to address the issue of identifying China's role in international trade in services and its strategy in negotiating specific commitments in each subsector.

Table 1

WORK FORCE BY CATEGORY OF INDUSTRIES

Year	Total	Million persons Primary	Secondary	Tertiary	Composition (total as 1.00) Primary	Secondary	Tertiary
1953	213.64	177.47	17.15	19.02	.831	.080	.089
1958	266.00	154.90	70.76	40.34	.582	.266	.152
1963	266.40	219.66	20.38	26.36	.825	.076	.099
1968	319.15	260.63	27.43	31.09	.817	.086	.097
1973	366.52	288.57	44.92	33.03	.787	.123	.090
1978	401.52	283.73	70.67	47.12	.707	.176	.117
1983	464.36	312.09	88.14	64.13	.672	.190	.138
1988	543.34	323.08	122.95	97.31	.595	.226	.179

Table 2

TURNOVER VOLUME OF TRANSPORTED GOODS BY SECTORS

(unit: 100 million tn/km)

Year	Total Volume	Railway	Road	Water	Air
1978	9829	5345	274	3779	1.0
1979	11385	5599	745	4546	1.2
1980	12026	5717	764	5053	1.4
1981	12143	5712	780	5150	1.7
1982	13049	6120	949	5477	2.0
1983	14054	6646	1084	5788	2.3
1984	15694	7248	1536	6335	3.1
1985	18126	8126	1693	7700	4.2
1986	20148	8765	2118	8648	4.8
1987	22228	9472	2660	9465	6.5
1988	23825	9878	3220	10070	7.3

Table 3

TOTAL VOLUME OF TRANSPORTED PASSENGERS

(Unit: 100 million person/km)

Year	Total Volume	Railway	Road	Water	Air
1978	1743	1093	521	101	28
1979	1968	1216	603	114	35
1980	2281	1383	729	129	40
1981	2500	1473	839	138	50
1982	2743	1575	964	145	60
1983	3095	1776	1106	154	59
1984	3621	2046	1337	154	83
1985	4437	2416	1725	179	117
1986	4897	2587	1982	182	146
1987	5416	2843	2190	196	187
1988	6207	3260	2528	204	214

Table 4

EMPLOYEES OF THE TOURISM INDUSTRY (1982-1988)

1982	64736
1983	76798
1984	98388
1985	168357
1986	276463
1987	356801
1988	438987

Source: National Tourism Administration

Table 5

THE STATE OF THE TOURIST INDUSTRY

Number	*1980*	*1983*	*1984*	*1985*	*1986*	*1987*	*1988*
1. Total Traveller Arrivals (10,000)	570.25	947.70	1285.22	1783.31	2281.94	2690.23	3169.48
Foreigners	52.91	87.25	113.43	137.05	148.23	172.28	184.22
Overseas Chinese	3.44	4.04	4.75	8.48	6.81	8.71	7.93
Hong Kong and Taiwan Compatriots	513.90	856.41	1167.04	1637.78	2126.90	2508.74	2977.33
2. Total Foreign	6.17	9.41	11.31	12.50	15.31	18.62	22.47
Exchange earnings from Tourism (100 billion dollars)	6.17	9.41	11.31	12.50	15.31	18.62	22.47

Table 6

FOREIGN TRAVELLER ARRIVALS

		1987		*1988*	
	Country	*Persons*	*Percentage*	*Persons*	*1988/1987 (percentage)*
Total	172.78	100.0	184.22	100.0	106.6
Japan	57.77	33.4	59.19	32.1	102.5
United States	31.53	18.2	30.09	16.3	95.4
United Kingdom	8.37	4.8	9.66	5.2	115.4
Australia	5.86	3.4	6.10	3.3	104.1
Philippines	5.76	3.3	7.14	3.9	124.0
Singapore	6.41	3.7	6.54	3.6	102.0
Germany, Fed. Rep.	6.01	3.5	6.90	3.7	114.8
Canada	5.23	3.0	6.33	3.4	121.0
France	5.37	3.1	6.32	3.4	117.7
Thailand	5.85	3.4	6.58	3.6	112.5
DPRK	2.34	1.4	2.01	1.1	85.9
USSR	2.47	1.4	3.48	1.9	140.9
Italy	2.98	1.7	3.07	1.7	103.0
Switzerland	1.70	0.1	1.64	0.9	96.5
Netherlands	1.31	0.8	1.65	0.9	126.0
New Zealand	1.09	0.6	1.24	0.7	113.8

Table 7

CHINA'S TOURISM RECEIPTS (1979-1988)

(million dollars)

Year	*Receipts*	*Indices (1979 = 100)*	*Growth Rate (percentage)*
1979	449 27	100 0	-
1980	616 65	137 3	37 3
1981	784 91	174 7	27.3
1982	843 17	187.7	7 4
1983	941 20	209 5	11.6
1984	1131 34	251 8	20 2
1985	1250 00	278 2	10 5
1986	1530 85	340 7	22 5
1987	1861.51	414.3	21 6
1988	2246 83	500 1	20 7

Source: State Statistical Bureau

Table 8

DOMESTIC TRAVEL

Year	*Person/time (100 million)*	*Increase over Previous Year (percentage)*
A. Person/times		
1985	2 4	-
1986	2.7	12.5
1987	2.9	8
1988	3.0	3.5

Year	*Domestic Travel Revenue (RMB 100 million)*	*Increase over Previous Year (percentage)*
B. Revenue		
1985	80	
1986	106	32 5
1987	140	30
1988	187	33

Table 9

NUMBER OF CONSTRUCTION ENTERPRISES AND EMPLOYEES

Year	*Total*	*State-owned*	*Collective*	*Rural Teams*
		Number of Enterprises		
1980	57404	1996	4608	50800
1981	55627	2586	4741	48300
1982	61684	2808	5076	53800
1983	66653	2885	6768	57000
1984	90141	3017	6724	80400
1985	93750	3385	7765	82600
1986	88771	3608	8977	76186
1987	87474	3788	9837	73849
1988	87224	3798	10336	73090
		Employees (million)		
1980	9.827	4.818	1.662	3.347
1981	1 0.340	5.093	1.759	3.488
1982	1 1.543	5.329	2.001	4.213
1983	1 2.853	5.445	2.581	4.827
1984	1 5.312	5.542	2.935	6.835
1985	1 7.013	5.767	3.348	7.898
1986	1 8.006	6.173	3.764	8.069
1987	1 8.735	6.182	4.059	8.284
1988	1 8.994	6.235	4.213	8.546

Table 10

Foreign Construction Contracts and Labour Services
(100 million dollars)

Year	*Contracts with Countries and Regions*	*Number of contracts*	*Contracted Value*	*Executed Value*
Total		7534	105 95	60 90
1976-1983	140	1352	21.73	9 69
1984	52	740	17.37	6 23
1985	71	923	12 65	8 35
1986	83	944	13 59	9 73
1987	95	1449	18 89	12 60
1988	103	2126	21.72	14 30
A. Foreign Construction Contracts		3446	89 00	49 70
1976-1983		893	15 96	6 27
1984		344	15 38	4 94
1985		465	11.16	6 63
1986		486	11 89	8 19
1987		616	16 48	11 14
1988		642	16.13	12 53
B. Labour Services		4088	16 95	11 20
1976-1983		459	5.77	3 42
1984		396	1 99	1 29
1985		458	1.49	1.72
1986		458	1.70	1 54
1987		833	2.41	1 46
1988		1484	3 59	1.77

TRADE IN SERVICES AND JAPANESE ECONOMY

The Japan Research Institute

INTRODUCTION

Over the past years, trade in services in Japan has been increasing. Technological innovations, the growing importance of services in the Japanese economy, the moves towards liberalization of services in industrialized countries, and the industrialization and growth of services demand in developing countries - all these factors form the context for this increase. Trade in services in Japan amounted to $37,060 million in 1989, which is more than three times the figure for 1978.

Generally speaking, the export performance of services in Japan has not been very strong. For more than 15 years, transportation, travel, and other services have shown deficit. On the other hand, investment income has generally shown a surplus, and this has increased in recent years due to the increase of portfolio investment in the United States financial market. Thanks to the large surplus in the current account, financial, wholesale and several other service industries have been active in investing in overseas markets, which might increase investment income in the future. However, the basic inclination of Japanese companies seems to be to reinvest their earnings in the countries where they established their subsidiaries. This would appear to suggest that the increase of investment income from overseas will never be very large. On the other hand, the trade deficit in travel and transportation is expected to increase further. Therefore, the Japanese balance in trade in services may continue to stay in deficit in the future. Although the account has always been in deficit, exports from management fees, patent royalties and fees have been growing significantly during the past decade, reflecting a shift towards inteleectual property and technology exports.

Service income in Japan will constitute 64.2 per cent of the entire national income in the year 2000 - this will involve an increase of more than 13 per cent compared with the figures for 1970 - according to the forecast made by the Economic Planning Agency (EPA). The share of employment in services will increase up to 61.8 per cent in 2000 from 47.3 per cent in 1970. These estimates do not clearly indicate the change of the industrial structure or the quality improvement of the service. However, the followings general comments may be made on the future changes in industrial structure in Japan:

- The role of business-support services will increase, especially in the fields of computer software development, various kinds of the business consultancy, information services, etc.

- In the manufacturing sector, manufacturers may try to improve competitiveness by producing goods which involve more service value-added.

- Newly developed services such as over-night delivery service will play a larger role in the future economy.

In general, there is no specific Government policy to promote the service sector, although the following elements need to be noted:

- The Ministry of International Trade and Industry (MITI) has been making large allocations from the Government budget for the development of the computer software industries. For example, the TRON project is trying to develop new "operating systems" suitable for the Japanese business, research and education fields. There are also subsidies to promote the development of computer hardware and software.

- MITI has also been promoting newly established services such as preparatory school, cultural services (complex of gym, athletics and other cultural schools), information services, sports clubs, etc. One of the recent promotion programmes has been to assist the establishment of industrial associations. Research on these new services has also been encouraged.

- Regarding traditional services, the Government policy has been to focus on the promotion or development of the small and medium-sized service firms. This has been done in connection with the promotion programmes of other small and medium-sized firms. Small-Enterprise Agency is responsible for the implementation of this policy.

I. STATE OF MAJOR SERVICE SECTORS IN JAPAN

A. Banking services

1. General situation

Different kinds of banking services can be identified, based on the following distinctions: (a) the separation of long-term and short-term financial functions, and (b) the separation of banking and trust functions. In addition to these function-based specializations, there are banks which specialize in financing small and medium-sized companies or agricultural, forestry and fishery industries. These banks may be Government-owned or private. This situation may perhaps be one of the reasons for foreign entrants finding it difficult to understand the Japanese banking market. As of April 1990, there are more than 1,100 banking institutions in Japan, which include 13 major commercial banks, 7 trust banks and 83 foreign banks. More than 850 of them are credit banks or unions which are normally small-sized and whose service operations are limited to local areas.

In recent years, the share of personal financial assets have been changing among banks, securities and insurance companies. The share of banks dropped from 40.9 percent in 1982 to 35.3 percent in 1987. On the contrary, the share of securities and insurance companies have increased from 16.6 percent to 20.3 percent and from 13.9 percent to 17.6 percent respectively in the same period. Also in the corporate business field, the share of borrowings from banks has gradually decreased. This is because many financial services have been newly developed by the securities and insurance companies, although banks have also been doing this. Recent liberalization in the financial sector has

intensified competition in the Japanese domestic market, and efficiency has improved. Accordingly, the Tokyo financial market has become one of the most attractive in the world. However, its liberalization is not yet completed; Foreign banks represented only 2 percent of banks in Tokyo in 1986, compared with almost 65 per cent in the London market.

Internationalization and liberalization in financial services has been rapidly achieved in Japan due to strong market pressures. In principle, foreign banks are entitled to national treatment (requirement of permit from the Ministry of Finance) for opening branch offices in the Japanese market. Several foreign stock dealing companies have also become members in the Tokyo Exchange Market. Nevertheless, the financial services sector is still far from being fully deregulated. A typical regulation is that concerning the intersection between securities operations and banking operations.

The investment of foreign banks in the Japanese market has been low. The investment amounts accumulated from 1950 to 1988 is $392 million, only 3.1 percent of the total investment amount (including manufacturing sector).[1]

2. Regulation in the banking sector

There are several laws governing the banking system in Japan, which include the Bank Law, the Long-Term Credit Bank Law, the Foreign Exchange Bank Law, etc. The outline of the banking services regulation in Japan is as follows.

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1 The country-wise numbers of the banks which have offices in Japan are as follows (as of June 1987): United States 53, Canada 7, Mexico 6, Brazil 3, Argentina 1, Others (Latin America) 1, United Kingdom 22, Italy 6, Austria 1, Netherlands 8, France 21, Belgium 4, Luxembourg 3, Federal Republic of Germany 17, Switzerland 18, Spain 6, Others (Europe) 16, Iran 1, Others (Middle East) 4, Pakistan 1, India 4, Malaysia 1, Singapore 10, Indonesia 1, Thailand 2, Taiwan Province of China 2, Hong Kong 6, Philippines 2, Republic of Korea 18, China 2, Australia 5, and New Zealand 2.

(a) Entry regulation

In order to provide banking services in Japan, the provider needs to obtain a licence from the Minister of Finance. The conditions of issuing the licence are: (a) asset requirement, (b) knowledge/experience, (c) market condition, and (d) capital requirement.

(b) Business fields

Banking and trust services are clearly separated by law. Banking institutions cannot operate securities and insurance services in Japan, as mentioned before. This is mainly because the framework of the Japanese financial system is based on the principle that the financial institutions should be specialized and separated. The establishment of the subsidiary companies is also limited. In general, only businesses closely related to banking services are permitted by the Ministry of Finance.

(c) Regulation of interest rates

There are two kinds of interest rates in Japan: (a) "free interest rate", and (b) "regulated interest rate" notified by the Ministry of Finance. Free interest rate has been applied to larger deposit amounts, but the upper limitation of the deposit has been lowered and it is applied to deposits of over ten million yen and to three million yen money market certificate. Regulated interest rate is applied to savings accounts.

(d) Establishment of branch offices

The approval of the Ministry of Finance is required for opening new branch offices, changing the location of current offices, closing existing offices and changing the status of offices, unless notified by Ministerial ordinance.

(e) Other regulations

Opening time and date of the bank including operational hour of the cash dispensers are regulated by the authority.

3. Government attitude to foreign banks

The Japanese Government has taken the position that new entry to the banking sector should be allowed, although the basic attitude has been that reciprocity must be maintained. However, the Ministry of Finance changed the Ministerial ordinance for the opening of branch offices in the Japanese market by the foreign banks few years ago. Foreign banks can now open branch offices without the limitation on the numbers of offices. This means that national treatment of banking services could be realized in almost all banking operations for foreign banks.

The regulation on the intersection between banking and securities operations has been prohibited by law. However, if foreign banks establish subsidiary companies in Japan, these companies can deal with security operations. Universal banks (mostly from European countries) are allowed to undertake security dealings in Japan on the condition that the capital investment of parent companies is limited to less than 50 per cent.

At present, there may not be any banking regulation that heavily discriminates against the banking operations of foreign banks in the Japanese market. However, the administrative guidlines provided by the Ministry of Finance may not be transparent to foreigners. The Ministry of Finance has a right to audit each bank and, based on such auditing, the Ministry provides administrative guidance to the bank. There are also some rules which foreign banks may not find easily understandable. For example, banks or long-term credit banks can apply to the Minister of Finance for trust services, but there are no written criteria for issuing licences.

B. Securities business

1. General Situation

The Tokyo stock exchange market has been rapidly growing for the past ten years. In 1988, the transaction amount was 286 trillion yen which was 5.2 times that of 1983. Also the bond market has increased by 16.9 times in comparison with 1982, to 5,786 trillion yen. The factors behind this growth are: (a) the trend of securitization - the private sector tends to raise funds at the security exchange market or bond market rather than borrow money from banks, and (b) the increase in the number of personal investors.

Internationalization of the securities market was also observed. Six foreign security companies obtained approval to get the membership right at Tokyo security exchange market in 1985 and 16 more companies in 1987. As of the end of 1988, there were 268 securities companies including foreign ones. However, the four biggest companies have a major share in the dealing of the stocks. It has been argued that the price level of the stock market might be controlled by the biggest four.

The expansion of membership in Tokyo Stock Exchange Market has been requested by many foreign firms. The external demand for a further expansion of membership continues. On the other hand, within Japan, the concern that priority should be given to domestic firms in increasing members of the Stock Exchange Market has been voiced.

Foreign firms have also been demanding improved access to the government bond market in Japan. While the market for treasury bill and mid-term government bond can be accesed by bidding, as far as the long-term government bond market is concerned the share of financial firms are partly pre-fixed. Although the share of bidding increased, it is difficult to say that foreign firms are treated fairly in the long-term government bond market when part of the market is reserved for domestic firms. This is particularly so, when Japanese securites firms win the bid for 40 to 60 per cent of government bonds in the United States.

Some foreign firms felt that the time which it takes to obtain the licence for starting securities business is an obstacle to trade, and that the criteria for the selection of members for the Tokyo Stock Exchange Market is not transparent.

2. Regulation of the securities sector

(a) Entry regulation

Securities companies need a licence from the Minister of Finance. There are four kinds of licences: (a) asset requirement, (b) brokerage operation, (c) underwriting operation, and (d) selling operation. The conditions for issuing new licences are almost same as the case in banking service, namely (a) enough properties to be able to provide the services, (b) necessary experience and knowledge to operate the services, and (c) the supply/demand condition in the financial market. Foreign securities companies need to obtain a licence for each office, and a licence must be issued for each line of business operation. Securities companies can conduct business only within the authorized areas. Banking institutions and insurance companies are not permitted to enter the securities sector.

(b) Regulation of the dealing charges

The securities companies are required to charge the customer appropriate charges, and to follow the rate of the charge decided by the stock exchange market itself.

(c) Establishment of branch office

The establishment of new branch offices, change of location of existing offices, and transformation from sales offices to branch offices

are regulated by the Ministry of Finance, and the approval of the Minister of Finance is required for these.

(d) Other regulations

There are many other regulations governing disclosure, insider-transactions and self-regulation by the stock exchange market and the security companies association.

C. Insurance Services

1. General situation

There are 30 life insurance companies including 5 foreign life insurance companies, and 24 domestic and 38 foreign liability insurance companies. The total contract amount of life insurance is 1,079.4 trillion yen which is 3.9 times the national income. As in the securities market, the four biggest insurance companies have 56 per cent of the share in life insurance and 48 per cent in liability insurance. In the insurance market, there are other competitors such as the PTT or agricultural co-operatives.

In Japan, insurance services businesses are regulated by the Insurance Business Act, which prescribes that insurance services should be divided to life insurance and liability insurance. An insurance company cannot operate both life and liability insurance. Many liability insurance companies have operational offices or subsidiaries in foreign markets in order to offer maritime insurance services or to make a contract of reinsurance with foreign insurance companies. More than 70 liability insurance companies have already set up their offices or subsidiaries in foreign countries. In contrast, the overseas activities of life insurance companies have been small in number. However, their financial operations in the world-wide financial market are quite active and they have established foreign subsidiaries for operating their funds. The numbers of such subsidiaries exceeds 70.

There are a number of foreign insurance firms operating in Japan, both in the fields of life and casualty. Although they do not have long business experience in the Japanese market, they are operating actively and gaining market share by selling various new innovative products, of which more are expected to be introduced by foreign firms to the Japanese market in the future. If Government authorization for the marketing of these products does not come promptly, and if the criteria for providing authorization lacks transparency, foreign firms may consider themselves subject to protective measures. Foreign insurance companies in Japan seem to be aiming at penetrating the large corporate pension funds market, which is estimated to reach 60 to 70 trillion yen in 2000.

2. Regulations in the insurance sector

(a) Entry regulation

Insurance companies need to obtain a licence from the Ministry of Finance. The licence is divided to 27 categories, namely one life insurance licence and 26 liability insurance licenses. While for a company that wishes to do business in life insurance one license would be sufficient, in liability insurances, separate licences are required for individual services. Foreign insurance companies can obtain licence as a company (not as branches or sales offices as in banking or securities services). The law specifies only that the company must have at least 30 million yen of capital or funds, and leaves the other conditions for the Minister of Finance to decide.

(b) Regulation of Business lines

A life or liability insurance company cannot operate businesses other than insurance services. Life insurance companies cannot provide liability insurance services and vice versa.

(c) New products

The introduction of newly developed insurance services requires the approval of the Minister of Finance. Generally speaking, domestic insurance companies provide the same services even in newly developed products.

(d) Investigation

Liability insurance is investigated by an organization established by law, and the Minister of Finance approves the result of such investigation. Accordingly, insurance charges are almost the same among various companies. Life insurance does not have a similar means of investigation within the organization. However, the approval of the Minister is needed in life insurance as well, and as in liability insurance, most companies provide services at the same rate.

(e) Sale of insurance

There are several regulations concerning the sale of insurance services. For example, salesmen and saleswomen of life insurance as well as agents of liability insurance have to register with the Ministry of Finance.

D. Telecommunications services

1. General situation

The Japanese market of telecommunications services has expanded after the privatization of NTT and the amendment of laws related to telecommunication services in 1985. In Japan, telecommunication services are categorized by the type of activity in which they are engaged, as shown in figure 2. To do business in the field of type 2 telecommunications services is now almost free, not only

for domestic companies but also for foreign companies, although type 1 carriers are limited to domestic companies.

Foreign firms feel that the restriction on the use of some telecommunication networks has been a barrier to their business activities in Japan, since it hinders access to the market for value-added information serivces. On the other hand, it appears that foreign firms were treated more favourably than domestic ones when technical standards were beign drafted in Japan, as the former were consulted during the drafting and the latter were not. In general, in the telecommunications sector, it can be said that the principle of national treatment is practised in Japan.

Recently, there have been negotiations on trade in wireless mobile phone systems between the Japanese and the United States Governments. The market for mobile phone systems (both automobile and hand-carry types) has been expanding rapidly during recent years, and American companies have started offering such services in selected areas in Japan. The issue in the Japan-United States talks was the allocation of the frequency for mobile phone systems. The United States succeeded in getting additional frequency bands, which has facilitated the business of United States firms in Japan.

2. *International telecommunication services*

In the field of international telecommunication services, there are already two new entrants besides Japanese KDD.[2] After some administrative procedures, their entry was approved by the Ministry, and both the new entrants have been expanding their market shares in international telecommunication services. International Telecom Japan and International Digital Communication are the new entrants which started international telephone services in April and May 1990 respectively. The service areas of these firms have also expanded over the past year and they now cover North America, as well as most European and

2 Kokusai Denshin Denwa (KDD) is a Japanese telecommunications company which deals with international telecommunications operations. It was the only company in Japan to deal with international telecommunications business.

Asian countries. The rates offered by these companies were initially about 30 per cent lower than that of KDD. However, KDD has been trying to reduce its rates and the difference between KDD and two new service companies has recently dimnished. The major clients of the two new entrants range from big companies to small and medium-sized firms. So far, their business lines have involved simple or traditional telephone service, and not high value-added services such as international VAN services.

3. Satellite telecommunication services

Two satellite and telecommunication services companies were granted approval, and started functioning in 1989. The services provided by these firms so far have been confined to domestic telecommunications. The trading companies (Sogoshoshas) have already joined the satellite telecommunication services with a form of investing equities, i.e. a form of joint venture. The reasons for this include: (a) the trading companies have been trying to diversify their business lines by entering the service sector, since they feel that prospects of trade in goods will reach its maximum potential in the future; (b) trading companies have also started cable network television cable television, services in the Tokyo area in joint-venture arrangements with other media companies. The trading companies are in a position to provide good quality or high value-added services in cable television, as they can easily integrate services by using satellite telecommunication, (c) the trading companies can also engage in importing satellite telecommunications equipment for distribution in Japan, (d) in future, trading companies might be able to provide information services through their world-wide networks. Therefore, while the entry of Japanese trading companies into the telecommunications sector may not have a substantial impact immediately on trade in services, the import of audiovisual services such as films and TV programmes as well as the fee for such services may increase.

E. Transportation services

The transportation sector includes following services: railways, road transport, maritime services, air transport, warehousing, and other services (e.g. forwarding).

1. Air transport

The international provision of air transportation services is usually negotiated between countries on a bilateral basis under the IATA system. During the past decade, following the lead of the United States, many countries have deregulated their air transport markets. In Asia, the level of development of the sector differs greatly from country to country. As the air transportation companies in these countries are nation-owned carriers under direct governmental control. .

In 1985, the Government amended the existing regulations to introduce the following measures: (a) double trucking system in international routes; (b) privatization of the Japan Air Lines; (c) double or triple trucking on domestic routes; and (d) introduction of flexible fares. Accordingly, The All Nippon Airways and the Japan Air System succeeded in penetrating international routes, and the newly established Nippon Cargo Airlines has started providing international cargo services.

The Government has been gradually moving towards a more open market for air services, though foreign carriers still face a number of problems, the most important being the limitation of landing capacity in international airports. For example, the New Tokyo International Airport (Narita Airport), which has crucial importance for international services, has already reached its maximum landing capacity, and its expansion will take a considerable time for completion. To solve this problem, the Government has recently approved the use of local airports for scheduled international flights. For example, Sendai and Chitose (Sapporo, Hokkaido) airports, previously confined to domestic flights and some chartered international flights, are now serving scheduled international flights. There are eight local airports, excluding Tokyo, New Tokyo and Osaka, serving direct international flights. The cargo-handling capacity in Narita Airport has also reached its upper limit, and foreign carriers have criticized the discrimination in the use of cargo handling facilities at Narita Airport. Accordingly, some foreign airlines have considered moving their main depot in Asian market from Japan to other countries in the region. On the other hand, some Japanese local airports are trying to develop the handling of interna-

tional cargo. They plan to receive the cargo for overseas from other domestic airports and send them in international flights to their final destinations. This movement to local airports has been supported by local governments. Foreign civil aviation firms also feel that the duty imposed on imported machines for ground handling and the difficulty in reserving seats for domestic transit from Narita Airport constitute trade barriers in the air transport industry.

2. *Maritime transport*

Japanese maritime companies have been facing a difficult situation after the appreciation of the yen against the United States dollar in 1985, mainly because of low-fare challenge from developing-country carriers. Containerization has led to the creation of new types of maritime services such as consolidated cargo transportation. The function of international freight forwarders, who as agents co-ordinate the functioning of integrated cargo transport services internationally, has become important in the provision of these services. In Japan, maritime service companies, big trading companies and warehouse companies have entered this business. Japanese forwarding companies have expanded the number of their foreign subsidiaries to more than 300. On the other hand, foreign forwarding companies have also been establishing their subsidiaries or agent offices in Japan - these number around 100.

One of the important issues in the Japanese shipping industry is the employment of foreign crew. Although foreign crews are employed by Japanese shipping companies, due to pressures from trade unions, this practice has been limited. The employment of foreign crew will be a crucial issue for the Japanese shipping industry in order to make the industry more competitive. No permits were issued to foreign firms in shipping-related auxiliary services, and this is considered as a protective measure by foreign firms.

It is envisaged that the market structure of international shipping in East Asia will shift from the present situation, where Japan forms the centre of the market, to one with several main hubs.

F. Construction industry

1. General situation

In Japan, the construction industry is categorized as a secondary industry according to the standard industrial classification, although in the United States and Canada, construction is categorized as a service. Construction is treated as a service industry at multilateral or bilateral negotiations, particularly due to the fact that the service, as opposed to the material content of construction, is much greater in international transactions.

The construction industry in Japan was traditionally oriented towards the local market. However, since 1980, the industry has been actively exporting its services to overseas markets, primarily by establishing subsidiary companies.

2. Activities of foreign construction companies in Japan

There have been negotiations between the Japanese and the United States Governments on opening the Japanese construction market. As a result, several American and Korean construction companies have obtained permission to provide construction services in Japan in 1988. There have been further negotiations on this issue with the Governments of the United States and the Republic of Korea. Firms from both countries appear to aim at joining the "Kansai new airport project", the initial construction process of which is currently under way. In general, foreign construction companies can participate in the project only if they fulfil the Japanese regulations for construction business and obtain a licence from the local government. There are several foreign construction companies who could obtain the government licence. The participation of foreign construction companies in the big "national project" is expected to increase in future. Recently, as a result of the Japan-U.S. bilateral trade negotiations, the Japanese Government agreed to open 17 large scale public projects for tenders

from foreign construction companies without the past record requirement. Another 17 projects, e.g., Second National Theater, New Chitose Airport in Hokkaido, re-development projects of big railway stations in metroplitan cities, etc., will be open to foreign construction firms in the same condition. The public notice for the tenders will be released well in advance and the period of the nomination of the tenderers will be longer than in the past. The Japanese tendering system, has also been a major issue in the Japan-United States talks, especially for public construction works. These issues are closely related to key principles in the Uruguay Round negotiations, such as national treatment, transparency, most-favoured-nation and reciprocity.

3. Characteristics of the Japanese tendering system in construction

The Japanese construction industry has some specific peculiarities - there are very few engineering or consulting companies in the market, and engineering and consultancy services are usually provided by the construction companies or clients themselves. In many other countries, independent engineering or consulting companies have been established, and such companies have attempted to penetrate the Japanese market. As the result of the Structural Impediments Initiative (SII) talks between Japan and the United States, the Japanese Government has been considering setting up new guidelines for Japanese-style tendering system. The peculiarities of the tendering system, especially in public works, include features such as the so-called "past records principle". If a client calls for tender, either open tender or tender for nominated vendors, past records on the same type of works such as bridge construction, road construction, etc. are required. So if new entrants wish to participate in the tender, they would need to have some records of actual experience in the same type of jobs. There is also a subcontracting system in the Japanese construction industry. Large-sized construction companies sometimes subcontract many jobs, and at times more than half of the project jobs may be given to subcontractors. The Conditional Offer of Japan on Initial Commitments which was submitted to the Group of Negotiations on Services, indicates that there are no restrictions on trade in construction services

through cross-border delivery, movement of consumer and commercial presence. However, in practice, this sub-contracting system could be a constraint for foreign construction companies because they might face to difficulties in organizing suitable sub-contracting partners, unless they make up the joint ventures with Japanese ones.

G. Cross-border mobility of labour

The issue of foreign workers in the Japanese domestic labour market has been discussed recently in various fora, including Government agencies. There are many foreign unskilled workers in the Japanese labour market, many of them working illegally in sectors such as construction, food services, other services. There are several reasons for the increase in the number of foreign workers in Japan - firstly, the difference in wage level between Japan and neighbouring Asian countries, exacerbated by the appreciation of Japanese yen against the United States dollar; secondly, the inadequate employment possibilities in such countries; thirdly, low demand in the construction market in countries in the Middle East, Asian workers who formerly worked in the region have entered the Japanese market often with tourist visas; and finally, the sustained economic growth in Japan and the increase in the demand for labour forces in various Japanese service industries.

Though the number of workers compulsorily expelled by the authorities is available, no data can be obtained for the numbers of illegal unskilled workers staying in Japan, which is estimated to exceed 200,000. In June 1990, the immigration law was amended and, as a result, legal action can be taken against an employer who employs illegal foreign workers. At the same time, the amendment has widened the scope of the skilled foreign workers, because it increased the number of visa classifications, most of which are professional or academic, and provided for a wider interpretation of the classifications. The Japanese Government is now considering relaxing the regulation on technological trainee receiving system with developing countries. Although the purpose of this system is to promote technology transfer to such countries, it has been considered to some extent as a system to utilize un-skilled foreign workers.

International labour movement may well be one of the key factors which merits consideration in the context of multilateral rules on trade in services, since trade in services in many cases entails the movement of people. Moreover, some developing countries have demanded that labour itself should be included among the issues to be discussed in service trade negotiations and that rules on international mobility of labour should be formulated. It is also a fact that, in Japan, issues related to the reception of guest workers have provoked much controversy, irrespective of service trade issues.

The major issue of debate in Japan is whether and on what terms Japan should open its unskilled labour market. Proposals have been made by some for a "project-oriented" opening method. This means that the Government approves the entry of unskilled labour into Japan only for specific projects - e.g. a large national construction project - and foreign workers should return to their home countries once the project is completed. Others have argued that the Government should establish a public agency to receive foreign workers, to arrange the necessary training (including teaching Japanese language), to send them to the Japanese companies for work and then to return them to their home countries at the end of the contract period (usually two or three years).

On the other hand, when it comes to some areas in services where expert skills and knowledge are called for, it is impossible for experts to provide their services unless they go to overseas markets in person. For example, the Japanese society is facing a shortage of nurses and caretakers, and it is envisaged that this shortage will be acute in the future. At present, foreign nurses and caretakers can not work in Japan. The Conditional Offer of Japan indicated that there are no restrictions on the conditions of market access and national treatment in the health service sector for any type of mode of delivery, except the movement of personnel. The movement of experts to provide services of this type is considered as essential for enhancing the quality of services, they result in higher living standards for individuals.

Developing countries have also displayed a keen interest in the formulation of rules on trade in services which would provide some clear rules and specific concessions in this area. Some of them, who have a large reserve of labour at home, have advocated the liberalization

of international labour market. By the nature of the service sector, transactions in services often entail the movement of people, and currently such movement exists to a considerable extent between industrialized countries.[3] Some countries are in need of importing workers from abroad on account of their labour-market structures, while other countries are restricting the inflow of alien workers primarily due to the apprehension that guest workers may narrow their domestic labour markets by depriving their people of jobs and may pose problems for social cohesiveness; however, there is a growing need for the countries concerned to formulate rules to provide an accepted structure for cross-border migration of labour as a "mode of delivery" for the expanding trade in services.

II. SERVICE TRADE AND DIRECT INVESTMENT

Table 3 shows the trends of foreign direct investment in the Japanese non-manufacturing sectors. It indicates that the foreign direct investment in the service sectors has been rapidly increasing for the past six years and that financial/insurance, wholesale including trading companies, and real estate account for 22.5, 10.7 and 11.5 per cent respectively, of the total foreign direct investment of Japan (including the manufacturing sector). The direction of foreign direct investment in selected service sectors are also mentioned in the table, which shows that North America has a major share of between 35 to 40 per cent of total non-manufacturing sectors. Europe has a share of 15 to 20 per cent. The increased investment to North America since 1985 has been concentrated in the financial/insurance sectors.

Looking at the trends of inward investment to Japan, the accumulated amount of investment by foreign companies in Japan still remains at a rather low level, although recent trends of inward investment shows rapid and steady expansion. The accumulated amount of inward investment was $15,653 million at the end of March 1989, while outward investment was $253,896 million.

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3 See Pang Eng Fong and Linda Low, "Labour Mobility, Trade in Services and the Uruguay Round: The Perspective of ASEAN countries", in volume One of this publication.

Due to the specific characteristics of service trade, the securing of establishment rights and commercial presence becomes an important necessary condition for the expansion of trade in services. Furthermore, the globalization of corporations and the growing mutual interdependence of corporations have led to rapid increases in foreign direct investment made by service industries. Increasing demand and supply for services provided by foreign law firms in the Japanese market would be a prominent example. Recently, a new decree Special Measures Law concerning the Handling of Legal Business by Foreign Lawyers, was introduced, and it became possible for foreign law firms to establish their offices in Japan although their activities are limited to the areas concerning the laws of their home country.

Under these circumstances, one may presume that services provided across national borders (the import/export of services) will decrease while services dispensed by foreign corporations operating in their host countries will increase. However, the statistics on services provided by foreign-affiliated corporations established through direct investments is much in arrears.[4]

The regulation of inward investment into the Japanese market has been more liberal since the change in legislation in December 1980. However, there have been complaints from investors, and the Japanese Government acknowledged the importance of the direct investment by foreign companies and made a statement on "the openness of the investment policy" in June 1990. It specifies that direct investment to the Japanese market by foreign companies is very important for the deepening of interdependence with foreign countries as well as for the growth of Japanese economy. Based on this, several programmess for the promotion of inward investment have been considered, including the expansion of the inward investment promotion finance system for foreign companies operated by Japanese Development Bank.

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4 See Maria Dunavoglyi, "Statistics on service Trade in Asia", elsewhere in this volume.

III. JAPANESE POSITION ON SERVICE NEGOTIATIONS

There are several ministries concerned with negotiations on trade in services. The Ministry of International Trade and Industry (MITI) seems to be crucial in promoting free trade in services, since the industries being controlled by the MITI such as advertising, software and system engineering, and database industries have little experience in export or in foreign direct investment. MITI also seems to believe that deregulation in the service sectors will improve the performance of the Japanese economy. On the other hand, other ministries such as the Ministry of Finance, the Ministry of Transportation and the Ministry of Post and Telecommunication, have maintained a rather reluctant attitude with respect to the Uruguay Round negotiations on trade in services. One reason for this may be that the deregulation of financial, transportation and telecommunication industries might involve a redefinition of the basic functions of these ministries.

The Japanese submission to the Group of Negotiations on Services (GNS) clarifies the basic standpoint of the Government in relation to principles such as transparency, liberalization, market access, national treatment, MFN treatment, etc. The major Japanese objectives in the negotiations can be summarized as follows: (a) to promote the expansion of trade in services through trade liberalization; (b) to prevent trade friction arising with respect to trade in service sectors and restrictive measures on trade in services; and (c) to keep trade freedom in the unified EC market scheduled for 1992.[5] However, it appears that there has been no clear statement on how to co-operate with developing countries, especially Asian countries, in the negotiations on services. It has been argued by some that Japan can and should play a leading role in the negotiations. However, for this, co-operation between the industrialized and the developing countries is essential, and Japan as well as other trading countries would need to promote a consensus involving the service interest groups within their countries.

5 See R. de C. Grey "1992, Service Sectors and the Uruguay Round" in *Trade in Services: Sectoral Issues*, UNCTAD ITP/26 Geneva 1990, also "1992, Financial Services and the Uruguay Round" UNCTAD Discussions paper, March 1991.

The Conditional Offer of Japan concerning Initial Commitments was submitted to the Group of Negotiations on Services in the Uruguay Round of trade negotiations. Although, an attempt has been made to analyze its implications to the current trade regime in Japan, this was made difficult by the fact that the detailed explanations of the Japanese conditional offer have not been officially released. In the offer the concessions were described by sub-sector, and in most of the cases the status of "no restrictions" or "stand still" are granted to the conditions on market access and national treatment. Although the concessions may reflect a real picture of rules and regulations they may not be useful to foreign service suppliers. Supply of services often requires delivery of other services or goods, and this complementary aspect of trade in services must be taken into account in the offer. Also, business practices would be a important issue in some services because they could serve as a serious constraint for new entrants to carry out their business activities in the Japanese market. This issue needs to be discussed in the multilateral trade negotiations on trade in services when they will enter sectoral negotiations.[6]

A. Activities in the private sector

In the private sector, the Japan Federation of Economic Organizations (Keidanren) has established the committee on trade in services in May 1987, which has members from various industrial fields such as financial, trading, telecommunication, electric and machinery, automobile, transportation, construction, retail, advertising, travel, hotel, real estate, etc. The major activities of the committee include the following: to exchange information on the GNS negotiations, to study the trends of Japanese service industries, and to collabourate with foreign service-related organizations such as the United States Coalition of Service Industries.

6 For example, the conditional offer of Japan indicates that there are no restrictions regarding business operations of foreign travel agents and tour operators in Japan in relation to cross-border delivery, movement of consumer and commercial presence. However, one of the major constraints for foreign firms to conduct their business in Japan would relate to the business practices of the domestic market and the structure of the Japanese tourism market. The market has been dominated by with several powerful domestic tourism agents who are the conglomerates of air and land transportations or hotel operation. Consequently, they have a firm grip on the computerized reservation and other information infrastructures which are vital for conducting tourism business inside and outside the country.

IV. ROLE OF JAPAN IN THE LIBERALIZATION OF TRADE IN SERVICES

A. Efforts to relax rules and regulations in services

1. Aimed at enhancing transparency

Although it might appear at first sight that foreign-affiliated corporations are enjoying national treatment in many areas of the Japanese domestic market, various problems faced by foreign-affiliated service corporations have been pointed out: they experience difficulties when entering the Japanese domestic market, and after entry, they encounter difficulties in conducting business. Some of these problems can be attributed to differences in service-market histories and market practices in different countries.

Like Japan, other countries have their own specific rules, regulations and market practices. For this reason, it is natural that the peculiarities of national practices are construed as trade/investment barriers by exporters or corporations contemplating overseas expansion in cross-border transactions in services (including entry into overseas markets). It is, however, virtually impossible to apply the same rules, regulations and market practices to all countries, since individual countries have different cultures, socio-economic structures, and national identities. However, it is important to create the conditions under which foreign-affiliated corporations or overseas corporations can get a clear understanding of the rules, regulations and market practices peculiar to a country. In other words, it is necessary to make the systems, rules, and practices in the service field more transparent.

To this end, it is necessary to reappraise the basic concepts of rules and regulations (for example, whether preventive restrictions should be adopted, or self-liability rules which become effective when a pertinent problem crops up should be adopted while keeping the number of rules and regulations to a minimum). At the same time, it

is also necessary to review the existing restrictions and rule systems, question the ground and rationality of existing regulations, and rethink ways of implementing these rules and regulations. Such reapprisals should be based on whether the following can be easily understood by foreigners: the contents of Japan's rules and regulations, the reasons for their existence, how they were formulated, etc.

2. *Relaxation of rules and regulations*

Many of the current rules and regulations appear to be no longer necessary, but remain in existence in many areas of the services. Amidst the growing world-wide trend towards the relaxation of rules and regulations, it may appear to be necessary for Japan to adopt appropriate measures in order not to lag behind its trading partners. Although relaxation measures have been introduced to these service sectors in Japan and they have begun producing positive results, many areas in services still retain rules and regulations from the past. This is because, unlike goods whose quality can be maintained at certain levels by means of specifications and standards, the quality of services hinges heavily on the competence and accumulated know-how of persons who dispense those services, and users cannot, in many cases, determine the quality of services until they receive them. This is true in other countries as well, where various rules and regulations aimed at maintaining service quality levels and protecting users have been formulated in accordance with their specific historical and socio-economic needs. While it is unlikely that rules and regulations themselves will completely disappear in the service sector in Japan or in other countries, it will be necessary to examine whether the regulations found in individual business lines are reasonable. If rules and regulations are found to be unnecessary by international standards or not in tune with the times they should be modified or abolished. Rules and regulations must be examined from the following points of view: consumer protection (the quality of services, protection of privacy, safety, heath, etc.), national security, national identity and the preservation of cultural traditions, conservation of the independence of the national economy, the balance between securing market competition and adopting competition-restricting measures, etc.

On the other hand, trade friction has spread from the field of goods trade to the field of service trade, and Japan is being increasingly pressured to proceed with further liberalization. It is pointed out that liberalization in services will increase their sophistication and promote the growth of Japan's economy in various respects by enhancing competition, while a failure to liberalize may result in firms avoiding the Japanese domestic market and in some of the service markets declining. Two typical examples of such markets are the financial and the securities markets. If there is too much delay and bureaucratic difficulties for a corporation to raise funds by issuing bonds in the domestic market, that corporation will probably do it in foreign market. In the securities market, as an increasing number of corporations get their stocks listed on overseas markets, customers are showing a tendency to converge on markets that charge less buying and selling commissions. With the progress of information technology, it has become extremely easy to raise funds in overseas markets and to close selling/buying deals in overseas stock markets. It should be noted that examples such as these are expected to multiply in future.

B. Formulation of international rules

1. *Sectoral negotiations*

International rules[7] for application to the field of service trade are being formulated in the Uruguay Round negotiations. Debates currently in progress in the GNS concern general principles designed to encompass the global service trade field, in the form of an umbrella agreement, or framework agreement. As for the negotiating process followed, general principles are to be agreed upon first, followed by negotiations on individual sectors. However, since the service field is made up of diverse sectors and since transaction modes vary greatly from sector to sector, it is impractical to think that all the issues can be solved by the application of general principles (although they may embody issues concerning national treatment, non-discriminatory

7 See M. Gibbs and M. Mashayekhi, "Developments in the Uruguay Round Negotiations on Trade in Services" in this volume.

treatment, reciprocity, etc.). Sectoral negotiations are expected to address the specificities of individual sectors, and countries are proceeding to make specific offers of concessions.

It is important that Japan prepares for the forthcoming multilateral sectoral negotiations by analysing the individual problems in various service sectors. As has been noted above, the Japanese Government has submitted its conditional offer of concessions concerning initial commitments to the GNS.

2. *Deliberations of transitory measures at multilateral negotiations*

As with past GATT negotiations, which approved of exceptional measures in the field of goods trade when necessary, it is considered that exceptional measures including grace periods may be needed in relation to the implementation of a service agreement. Such measures are considered necessary for developing countries who do not possess a competitive edge in many service sectors. Although it is not easy to assess the international competitiveness of each individual country in the service field, it is obvious at a rough estimate that the industrialized countries are stronger than the developing countries. Under the circumstances, it is deemed necessary that measures such as provisional safeguard clauses, preferential tariffs and import quotas may be necessary in the field of trade in services as well. By presenting these measures incorporating appropriate grace periods, as many countries as possible may be included in the service trade negotiations.

3. *Moves toward bilateral negotiations*

As evident from the United States-Canada Free Trade Agreement and the decision to negotiate a United States-Mexico Trade Agreement, the United States has been making considerable effort at concluding bilateral agreements, while at the same time proceeding with multilateral negotiations in GATT. Considering the fact that many of the agreements that were concluded in the past in the service field were bilateral, Japan may as well not only resort to multilateral negotiations

but also devise appropriate measures, keeping the possibility of bilateral negotiations in mind. Many of the problems that have arisen in the service field are bilateral problems. Among these, a large part of the problems faced by Japan stemmed from the difference between the benefits enjoyed by Japanese corporations in overseas markets and the benefits foreign-affiliated corporations enjoyed in the Japanese domestic market. Japan has been required to eliminate such differences, and it is considered important for Japan to devise measures also in bilateral (liberalization) negotiations. This, however, does not mean that Japan should solely rely on bilateral negotiations. In other words, if Japan intends to proceed further with liberalization, the country should do so by concluding bilateral agreements and multilateral agreements as needs dictate.

Figure 1
TRENDS OF BALANCE OF SERVICE TRADE

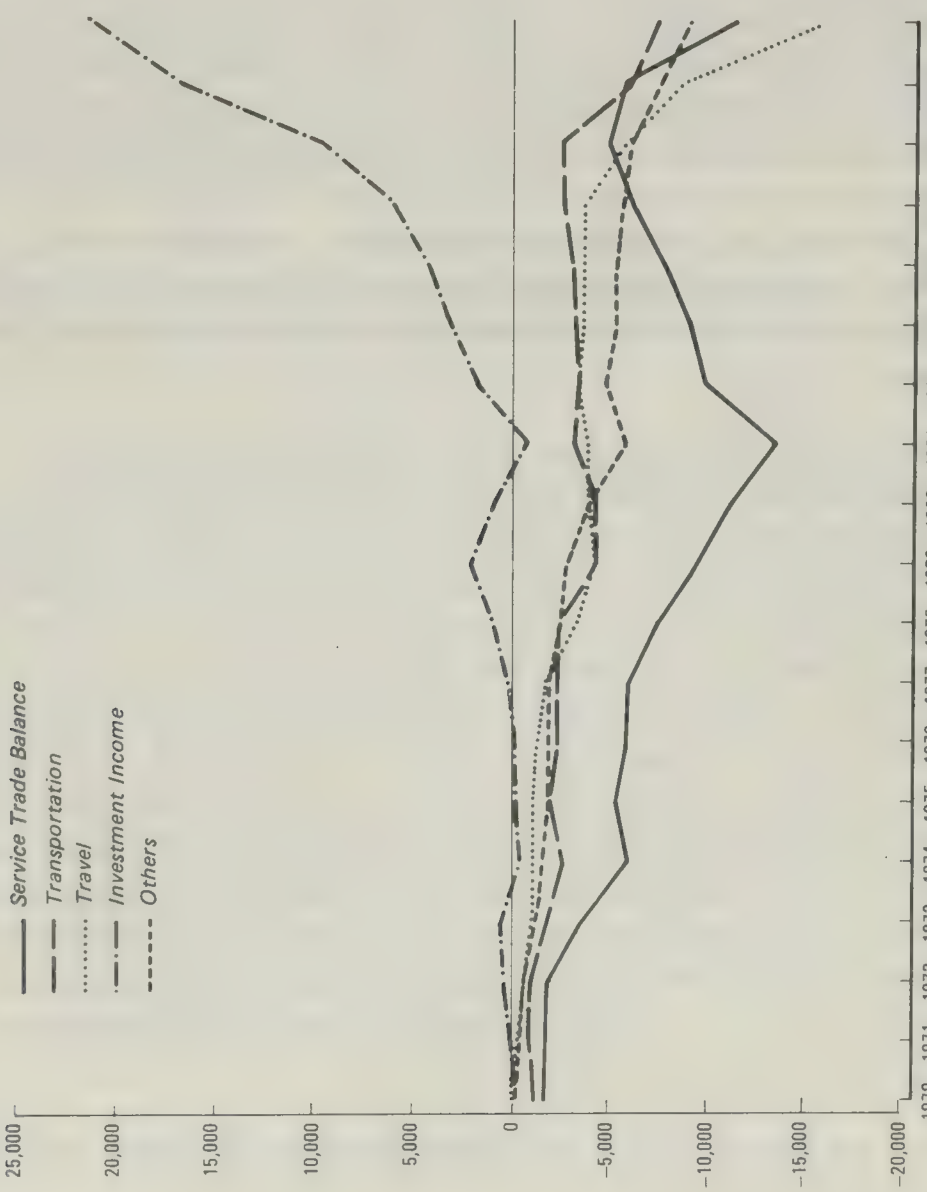
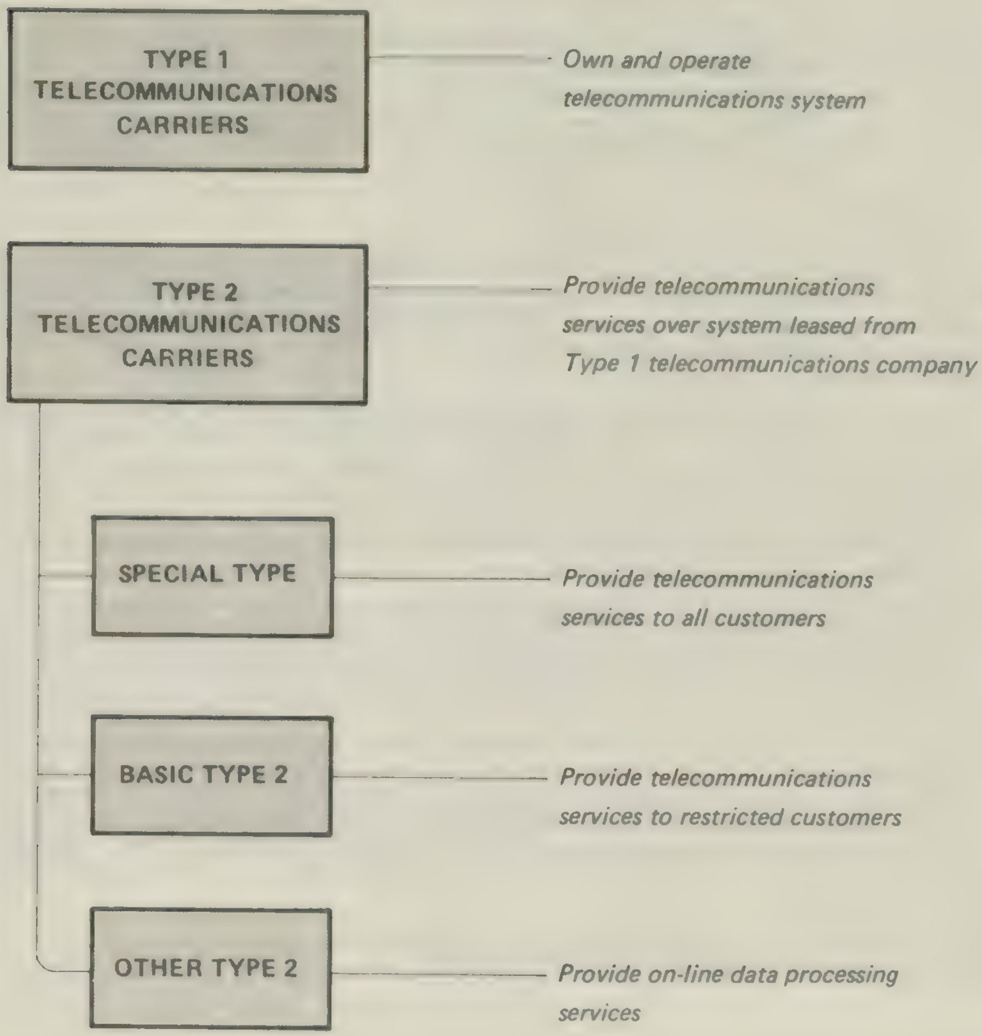


Figure 2
TYPES OF COMMUNICATIONS CARRIERS IN JAPAN



Box 1

AIR TRANSPORT MARKET IN JAPAN

Along with the rise in Japanese spending on leisure activities and holiday travel, there has been a surging demand for domestic and international travel in Japan. In response to this rise in demand, the Government introduced major changes to the way the three major airlines in the country operate, by abolishing the airline constitution in 1985. However, the access to markets as well as the fare structures of these airlines have been strictly controlled by the Government. Under the new guidelines, Japan Airlines (JAL) was assigned all international and domestic trunk routes, All Nippon Airways (ANA) was given domestic trunk and local routes as well as short-distance international charters, and Japan Air System (JAS) was assigned local routes and some domestic trunk routes. In 1987, JAL was completely privatized so that all three airlines could compete on the same economic basis.

It has been argued that the rules of the Ministry of Transport make entry and exit into the market extremely difficult, and keeps the market in its triple oligopolistic structure. Airlines are also protected by strict rules on domestic fares. Although the Government does not specify fares for each domestic route, airlines are not allowed to offer different fares, and there are no discounts.

Even though the domestic fares have not changed since 1982, the rising load factors have amply compensated for this. The rapid expansion of the market has ensured ample business for all three airlines. The Japanese Ministry of Transport allowed discount fares on international routes, arguably under pressure from foreign governments, and this has made the international routes price-competitive to some extent. However, with the capacity restrictions and strict control at the major airports, load factors have become so high that price competition on local routes has been relatively small.

Both ANA and JAS are trying to expand their international networks. While ANA, the eighth largest airline in the world in terms of passengers carried in 1989, wants to add seat kilmoetres on international routes at the rate of 27 per cent per year for the next five years, JAS envisages a rise in the number of its international passengers at the rate of 44.5 per cent per year in the same period. Capacity constraints of airports have hampered the expansion plans of these airlines to a considerable extent. In response to this, ANA has started co-operative ventures with foreign carriers such as SAS, Austrian Airlines, Sabena, and the Malaysian Airline System. ANA is also planning to start flights from a wider range of airports including regional airports such as Nagoya and Fukoka. JAS has also been considering these strategies, and plans to fly from the new Kansai airport (scheduled to open in 1994) near Osaka to Seul, Singapore, Bangkok, and Hong Kong. It also plans to exapand its destinations and to increase flights to existing destinations.

Source: *Far Eastern Economic Review*, 31 January 1991, pp. 36-37.

Box 2

BANKING SERVICES IN JAPAN

Access for foreign banks to the Japanese financial market became a trade issue and was included in the agenda of the United States-Japan bilateral trade talks which began in the early 1980s. The United States pressed for the liberalization of the Japanese financial market mainly for the following reasons: (a) the United States assumed that liberalization of the Japanese financial market would lead to the internationalization of yen and consequently to the appreciation of the currency, which would help to ease the trade imbalance between the two countries; and (b) United States was actively demanding the liberalization of international trade in services in GATT.

Comparison of the volumes of bank assets in Tokyo and London indicated that the total assets of foreign banks in Tokyo was extremely low representing 1.3 per cent in 1985, while the corresponding figure was 63.6 per cent in London. In terms of location 8 per cent of the total international financial transactions were excuted in Tokyo, while the corresponding figures for the United Kingdom and the United States were 23 per cent and 15 per cent respectively. However, Japanese banks handled 26 per cent of the total international financial transactions, while the corresponding figures for British and American banks were 7 per cent and 23 per cent respectively. These figures highlight the high degree of capital investment by Japanese banks and their active operation outside their home country.

Regarding obstacles to trade, as far as the principle of national treatment is concerned, the general view is that foreign banks in Japan are treated on equal terms with domestic banks. However, in practice, there might be a certain degree of disadvantage for foreign banks for the following reason. Presumably, the reliance of the foreign banks in Japan on the capital and money markets is higher than domestic banks because the number of branches of foreign banks is considerably smaller than in the case of domestic banks. However, the development of money and capital markets has not been that of the other international financial centres, and as a result foreign banks in Japan might have a difficulty in raising capital. It is also desirable for a further internationalization of yen, which is an expected trend for the currency of a country with a strong trade performance.

Acquisition of Japanese banks by foreign banks, both in terms of equity and management, requires permission by the Japanese Government in advance, and up to the present there is no precedent for such an acquistion. In practice, it is presumed that it would be difficult for foreign banks to aquire Japanese banks. However, acquistions of foreign banks by Japanese banks have taken place, and this might have resulted in making the permission requirement appear unfair.

The major obstacles to trade, which were noted by foreign banks in Japan include: (a) the difficulty in obtaining Government authorization to establish additional branch in cosmopolitan cities other than Tokyo; (b) the prohibition of mergers with Japanese and foreign banks; and (c) non-transparency in bank-client relation.

Source: *Service Boeki Jiyuka no Tameni* prepared by the Japan Research Institute, edited and published by the Economic Planning Agency, October 1988.

Table 1

FUTURE PROSPECT OF JAPANESE INDUSTRIAL STRUCTURE

Percentage Share of nominal GDP

	1970	*1980*	*2000*
Agriculture/Fishery/Forestry	6.0	3.7	4.2
Manufacturing/Construction	43.1	38.2	31.5
Services	50.9	58.1	64.2
Total	100.0	100.0	100.0

Source: The Economic Planning Agency.

Table 2

FUTURE PROSPECT OF JAPANESE INDUSTRIAL STRUCTURE

Percentage Share of employement

	1970	*1980*	*2000*
Agriculture/Fishery/Forestry	17.4	10.4	4.9
Manufacturing/Construction	35.2	34.8	33.3
Services	47.3	54.5	61.8
Total	100.0	100.0	100.0

Source: The Economic Planning Agency.

Table 3

FOREIGN DIRECT INVESTMENT

(Outward and Inward)

	1980	1985	1989
Outward			
Construction	37	94	646
Wholesale	797	1.550	5.148
Financial Insurance	380	3.805	15.395
Other services	251	665	10.616
Transportation	0	1.240	2.927
Real estate	0	1.207	14.143
Others	884	652	919
Total	4.693	12.217	67.538
Accumulated FDI	36.497	83.649	253.896
Inward			
Trading	41	86	544
Services	35	42	138
Real estate		7	647
Financial Insurance	77	89	180
Others		107	315
Total	299	929	2.860
Accumulated FDI	2.979	6.396	15.653

Source: The Ministry of Finance

FOSTERING THE GROWTH OF NEW SERVICE EXPORTS FROM DEVELOPING COUNTRIES

*Dorothy I. Riddle**

INTRODUCTION

With the initiation of multilateral discussions on the liberalization of services trade in the context of the Uruguay Round, governments have been focusing more attention on understanding the dynamics of the service sector. Previous work has documented the importance in the development process of the service sector in general,[1] and of producer services[2] in particular. If governments are to optimize the growth contribution of services, particularly new service exports, then there must be a clear understanding of the levers for growth and the policies necessary for their activation.

The present economic context presents both opportunities for developing countries to "leapfrog" in services development and challenges due to increased global competition. The opportunities stem from a combination of factors related to the two major sources of competitiveness in services - i.e. human-capital development and information management:

- Many developing countries now possess a work force with basic education.

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1 See D.I. Riddle, *Service-led Growth: The Role of the Service Sector in World Development* (New York, Praeger, 1986); UNCTAD, *Services in the World Economy* (United Nations Publication, UNCTAD/TDR/8/Offprint), as well as TD/B/1008/Rev.1, TD/B/1100, TD/B/328/Rev.1, and TD/B/1162.

2 The term "producer services" refers to those services sold to other businesses. In this paper, "business services" is used instead, including both professional services and business-support services.

- Many developing countries have substantially completed basic infrastructure (i.e. access to electrical power, transportation networks, telephone service), though further development and upgrading may be necessary.

- Telematic[3] technology, combined with over 8,000 economic and business on-line databases, makes it possible for smaller firms in developing countries to access global market intelligence from their offices in a cost-effective manner.

At the same time, the competitive environment for services is changing significantly due to the changes brought about by the following two types of international trends:

- Trends towards deregulation, increased price competition, and formation of free-trade unions (European Communities, Canada-United States, Australia-New Zealand) are creating increased consolidation in a range of industries such as accounting, advertising, finance, legal services, market research, telecommunications, and transportation.

- Trends towards privatization through divestiture or contracting out of former public monopolies are creating new private sector opportunities (such as prison management, waste management), with foreign firms competing with domestic firms for such business.

On the one hand, as a consequence, service transnational corporations (STNCs) are increasing in size and market dominance, with Japanese firms displacing United States firms. On the other, a series of networks is forming among smaller firms - e.g. mid-size accounting firms - in order to compete effectively with the STNCs.

Developing-country governments are therefore facing major challenges in how best to assist their private sector service firms to become or remain competitive. Most governments still lack adequate information about bilateral trade flows in services other than those linked to goods (e.g. freight, insurance) or the movement of people (e.g. air

3 "Telematic" refers to the linking of telecommunications and computer technology.

transportation, tourism). Few governments have in place trade networks that can provide service firms with timely market intelligence on the rapid changes taking place in the global markets for services. Nevertheless, initiatives must be taken in order to forestall complete dominance of world markets by service transnationals from developed market economies.

I. THE PRESENT COMPETITIVENESS OF ASIA-PACIFIC COUNTRIES IN SERVICES

Most of the Asia-Pacific developing countries are already predominately service economies, with services constituting the largest economic sector.[4] While the large continental economies of India and China developed primarily as agricultural economies, the peripheral maritime states developed around urban ports where service skills linked to trading flourished.[5]

More recent trends towards resource allocation to manufacturing have resulted in rapid growth in external trade, while concomitant growth in business services has not received the same attention.[6] Nevertheless, for leading economies such as Singapore, the Republic of Korea, and Hong Kong, services have remained an important component of both domestic growth and external trade.

In general, developed countries dominate world trade in services much as they have dominated world economy in general. For the Asia-Pacific countries, there is quite a range of disparity in service trade development. On average, the Asia-Pacific developing countries still accounted for proportionately less of services exported in 1987 than would be expected, but also were the only region to be posting con-

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4 See data in D. Riddle and M. Sours, "Service Industries as Growth Leaders in the Pacific Rim", *Asia Pacific Journal of Management,* Vol. 1, No. 13 (1984), pp. 190-99.

5 See D.I. Riddle and M.H. Sours, "Service-led Growth in the Pacific Basin", in W.C. Kim and P.K.Y. Young (ed), *The Environment of International Business: A Pacific Basin Perspective* (New York, UMI Research Press, 1987).

6 For example, during the 1980-84 period when attention was focused on the recession in Singapore's manufacturing sector, few noted that the productivity of business services were growing at more than 14 per cent per year, with management consulting growing at over 20 per cent a year. See *The Singapore Economy* (New Directions, 1986).

sistently positive growth. Japan, on the other hand, ranked highest world-wide for 1989 per-capita income[7] and is increasingly dominant in services trade. In the Times 1989 listing of the top 1,000 industrial firms world-wide, six of the top ten firms were Japanese - all sogo shoshas (trading companies) - with Nippon Telegraph & Telephone (NTT) ranked as number 17.

Singapore and the Republic of Korea routinely rank among the top 20 service exporters in the world. In 1987, Singapore ranked high in tourism and engineering exports, while Korea ranked high in shipping and construction.[8] For 1986, Thailand also ranked among the top 20 for travel exports and India for "other" services exports. Regarding imports the picture in 1986 was more mixed. Singapore and Indonesia ranked among the top importers of both shipping and "other" services. India, Malaysia, and Thailand also imported a significant volume of shipping, while Malaysia imported travel services and Korea imported "other" services.

Countries in the Asia-Pacific region accounted for five per cent of world trade in services by 1987. It is estimated that by the close of this century at least 50 per cent of the world's goods and services will be produced in the Asia-Pacific region, with more than 50 per cent of the world trade taking place between the Asia-Pacific countries and the rest of the world.[9]

As labour costs continue to rise in the region, countries are losing some of the competitive positioning available when exporting labour-intensive services. While there are major service firms in the region capable of competing successfully in world markets, the number is still few. Given the rapid growth occurring and predicted in the near future in many Asia-Pacific developing countries, pressures from service transnationals from developed countries to capture a portion of that growth market will increase.

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7 See R. Knee, "Intra-Asia Market Becomes No. 2", *American Shipper*, January 1990, p. 58.

8 See "Centre Stage for Services?", *Economist*, 5 May 1990, pp. 88-9.

9 "The Free Trade Agreement and Canada's Trade with Asia-Pacific Countries", *Thai-Canadian Business*, January-February 1990, pp. 16-17.

To illustrate potential strategies for developing new service exports, attention will be focused on two countries in particular - People's Republic of China and the Republic of Korea - though examples will also be drawn from the experience of other Asian countries. The two countries in question represent nations at quite different points in development. China, as the most populous country in the world, continues to rank among the low per-capita income countries and has developed primarily through the activities of State-owned enterprises. Republic of Korea, on the other hand, is soon to join the ranks of the OECD countries and has staged initiatives to develop private sector enterprises, albeit conglomerates.

II. INFRASTRUCTURE DEVELOPMENT TO SUPPORT SERVICES EXPORTS

As global competition in services increases, profit margins shrink and the cost and quality of inputs becomes particularly important. For service exporters, the quality of both social and physical infrastructure are critical - in particular labour force and telecommunications.

A. Labour force development

Though for some people the term "services" conjures up images of domestic low-skill workers, over half of the activity in world services is in "producer" services, most of which require skilled or highly-skilled workers. Certainly the rapid growth world-wide is in the professional and business services segment of producer services - with the degree of value-added being directly linked to the knowledge or human skill content.

1. Investment in general education

Skill and education levels are closely linked; therefore, the investment made by governments in the country's educational system is critical. In the United States, for example, it is estimated that more than half of the new jobs generated over the next decade will require more

than a secondary school education.[10] For the Republic of Korea, investment in education is quite high - 21 per cent of public expenditures, which is the highest in the Asia-Pacific region. By comparison, Japan spends 8.6 per cent, Singapore spends 13 per cent, and China spends 11 per cent.

With regard to the skill base of China's work force, 64 per cent of workers still have less than a secondary school education. Only 7 per cent of the work force have received an education beyond secondary school. At the other extreme, over half of the scientists and engineers have received university degrees. One growing problem is the "brain drain" as Chinese students educated abroad fail to return. Accurate statistics are difficult to obtain, but several years ago it was estimated that at least 6,000 Chinese graduate students in the United States alone had immigrated rather than returned.

With regard to Korea's skill base, there is tremendous pressure at the present time on the higher education system. Two new junior colleges have been granted licenses, but there is still more demand for training than educational facilities can handle.

2. *Investment in management training*

Another aspect of education and training that is of particular importance in value-added services is management training - a typical area of weakness in developing countries. One of the growth areas of new services exports is in streamlined management systems, which assume a critical mass of managerial expertise.

China is facing an interesting crisis regarding managerial expertise. The contrast between "mature" workers, many of whose education was disrupted, and the bright, risk-taking younger generation (which represents over half the work force in the State-owned units) is dramatic and tacitly recognized.[11] Given the cultural tradition of deference to

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10 See "U.S. Aims to Bridge the Skills Gap", *Worklife Report*, Vol. 6, No. 4 (1988), pp. 10-11.

11 At the administrative level of State-owned units in 1987, 42 per cent of all managers

chronological age, the Government is presently attempting a quiet, nearly-invisible, two-track system with dynamic subsidiaries being formed in key areas to parallel the positions already held.

While business administration programmes exist in Korea at the college and university level, there are as yet no courses offered on small business management or entrepreneurship. Parents still expect their children to work for one of the chaebols in order to ensure financial security for the parents' old age, rather than start and build new businesses. In addition, the strong emphasis on higher education (especially education abroad) means that there are many returning Ph.D. holders who are placed in managerial positions upon their return to Korea even if they have not in fact received management training.[12]

3. *Investment in entrepreneurial development*

Entrepreneurship represents a particular aspect of managerial activity, that associated with risk-taking and innovation rather than system maintenance. Entrepreneurs are the backbone of every economy, particularly in jurisdictions where smaller firms predominate. In services, where constant innovation is the only real hedge against competition, entrepreneurial vision and skill are particularly important.

Because of current attitudes about the private sector in China and the dominance of State-owned enterprises, there is considerable ambivalence about private sector entrepreneurs. The strategy being used at the present to substitute for private sector entrepreneurship is that of encouraging "intrapreneurship" in State-owned system through the creation of parallel service units. One of the difficulties concerns the constraints on risk-taking which can be attributed to the devaluation of expertise and of personal initiative.

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had completed no more than junior middle school and 81 per cent had been in their management position since before the "open door" policies of 1978.

12 See "Skewed Demand Brings Mixed Rewards at Home", *Business Korea*, August 1989, pp. 34-36.

In order for intrapreneurship to succeed in an economy like China where public-sector institutions predominate, a multi-pronged approach with the following objectives is needed:

- Promote change in values such that the intrapreneur feels an increased sense of personal responsibility, is less likely to accept constraints, and is more likely to value and seek out expert advise;

- Provide enhanced and accelerated management training to cadres without such a background, along with intrapreneurship training and incentives;

- Activate external funders to supply pressure in the form of contingencies dependent upon significant intrapreneurial activity;

- Create a national slogan to help value the risk-taking and profit-seeking behavior of the intrapreneur;

- Provide cadres with training in marketing and the distinction between marketing and selling; and

- Provide specific skills training in information systems, quality control, how best to integrate skilled women workers, and intrapreneurship.

There is already a great deal of entrepreneurial activity in Korea, with 16 new businesses a day being opened,[13] many of these firms in services. Clearly, individuals are willing to take the necessary risk and responsibility. However, a number of these ventures fail or do not reach their profit potential due to a lack of some basic business skills and concerns for parental welfare. Three interventions could be particularly useful:

- Provide funding to create courses on entrepreneurship and small business management at existing educational institutions for both students and executives;

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13 See "16 Business Enterprises Born Everyday", *Korea Trade & Business*, January 1990, p. 25.

- Provide funding to create courses for business persons in the practical use of computer information systems, with special application to their businesses; and

- Create a minimum social security system for the elderly so that younger persons feel freer to risk new ventures.

Given the generally good infrastructure and rapid spread of computers, the most pressing needs on the part of the Korean entrepreneur are for appropriately skilled workers and for growth financing. Training can be provided on both business information systems and quality control techniques. New workers are available among the female work force if gender can become less of an issue. Regarding financing, smaller firms do not have the financial resources of the chaebols and would need loan guarantees or other similar financing assistance.

4. Export opportunities in labour force development

An invisible and yet crucial form of labour export is that of supplying workers to foreign firms in the domestic economy. Countries vary in terms of the degree of regulation involved in such "exporting". In China, for example, virtually all Chinese workers in foreign firms are in actuality employees of the China International Trust and Investment Corporation (CITIC) on hire to the foreign firm. Under such an arrangement, the foreign firm pays to CITIC the foreign-scale wage, of which only a certain percentage is passed on to the worker. At the other end of the continuum are many countries, like Korea, where employment site is a matter of personal preference. In Korea, though, foreign firms such as banks have been the target of union demands for massive wage hikes.[14]

In some countries, the supply of skilled workers in foreign markets is a well-developed public-sector activity. Both Korea and the Philippines, for example, have labour bureaux that act as brokers

14 See M. Clifford, "Labour's Love Lost", *Far Eastern Economic Review*, 4 May 1989, pp. 68-69.

abroad and provide at least a minimum level of protection for the worker. Many developed countries are already dependent upon highly skilled talent from Asian countries.[15] Specific international skill-shortage areas could be targeted, provided that such skills already exist in the local economy. For example, Australia has been experiencing a shortage of maintenance technicians for servicing aircraft and would presumably welcome such individuals.[16] For the Korea Overseas Development Corporation, for example, ample opportunities exist to take a more proactive approach to labour supply abroad - identifying growth markets for value-added services.

In each of the above instances, the expertise in managing labour force exporting is one that could also be exported to other countries looking for mechanisms to absorb excess domestic labour. A parallel opportunity lies in exporting expertise in adapting worker-training programmes to local circumstances. For example, China has adopted a conscious policy to import business management training from the United States and Europe and then "repackage" it for a developing country context and export it to countries in Africa.

Several world trends in service sector employment also offer trade opportunities. One trend is being variously called "remote working" or "distance employment" or "tele-commuting" - i.e. workers off-site linked to their office via computers. By 1989 there were an estimated 26.6 million tele-commuters in the United States alone, both employees and self-employed, of whom 60 per cent were white-collar workers primarily in services.[17] For example, the State of California is just completing a two-year experiment in having 250 employees - data operators to judges - work from home two days a week.

Advantages include not only increased productivity (averaging around 20 per cent), but also the flexibility necessary to attract specially

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15 For example, approximately ten thousand Chinese engineers from Taiwan worked in California's Silicon Valley in 1989. See B. Johnstone, "California's Brain Drain", *Far Eastern Economic Review*, 19 October 1989, p. 55.

16 See P. Proctor, "Maintenance Technician Shortages Constrain Growth of Australia's Airlines", *Aviation Week & Space Technology*, 17 July 1989, p. 98.

17 See D.C. Bacon, "Look Who's Working at Home", *Nation's Business*, October 1989, pp. 20-31.

talented persons and an ability to save on increasingly expensive urban office space.[18] Trade opportunities for developing countries include:

- Provision of skilled workers "abroad" via electronic links without actual immigration or "brain drain";

- Provision of training programmes for both distance workers and their supervisors in how to manage a decentralized relationship effectively; and

- Provision of consultation (once experience has been obtained) to other jurisdictions on how to use tele-commuting for skilled job creation in rural areas.

A second trend leading to export possibilities is the increase in the use of temporary or contract workers in order to maintain a flexible cost structure. "Temps" are hired by firms for a variety of reasons - e.g. alleviate work loads, implement special projects, fill in for employees on holiday or sick leave.[19] In contrast to the usual practice of temps working essentially as self-employed persons without benefits protection, an increasing number of temps are in fact full-time employees of the temp agency.

"Temps" have traditionally been associated with office support staff, but increasingly it is the professional staff that is being supplied on a contract basis.[20] In addition to the traditional provision of office workers by firms like Kelly Girl Services, there is a rapidly growing market in a wide range of professional services: e.g. Legalstaff; Staff Builders (health car workers); CDI Corp. with 14,000 engineers (or 12 per cent of the available talent). GM, for example, has found that it can reduce its production cycle from five to two years due to using experienced supplemental labour.[21]

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18 See J.F. McKenna, "Have Modem, Don't Travel", *Industry Week*, 20 November 1989, pp. 26-30; S. Newman, "Telecommuters Bring the Office Home", *Management Review*, December 1989, pp. 40-43.

19 See L. Waller, "Here Come the Temps", *Electronics*, May 1989, pp. 91-93.

20 See D. Machan, "Rent an Exec", *Forbes*, 22 January 1990, pp. 132-133.

21 See M. Whittemore, "Temporary Solutions", *Nation's Business*, July 1989, pp. 48-49.

For the Republic of Korea, in addition to the services of the public-sector Korea Overseas Development Corporation, there are also private sector initiatives such as UNIDO business services. UNIDO provides temporary support workers of all sorts through the World Trade Centre network as well as independently. Such a service could be franchised and located at World Trade Centres around the region. Other types of trade opportunities for developing countries include:

- Provision of skilled temps, in addition to the present provision of unskilled or semi-skilled workers, to firms world-wide;

- Provision of consulting services to analyse when the use of skilled temps (especially from developing countries) would be cost-effective; and

- Provision of consulting services to jurisdictions (once experience has been gained) on how to assist aspect of the informal sector to reorganize into temp agencies.

B. Telecommunications development

While transportation networks are key for the movement of goods, telecommunication links are key for trading services. Because of the advances in telematics (including computer-phone links and fax machines), many services that used to be delivered only face-to-face can now be traded at "arm's length". For example, electronic barter "bulletin boards" allow for two- and three-way swaps between parties that have not met, and may never meet.

The telecommunications infrastructure of a country is vital to service export development - the lifeblood of services trade. In order to maximize effectively, the services need to be state-of-the-art, instantly accessible, and cost competitive.

1. Telecommunications and trade

A recent study on the impact of telecommunications shortcomings on the earnings of export companies in Kenya[22] has demonstrated that significant costs were incurred due to poor quality, inadequate capacity, and delayed repair services. Without considering the additional export contribution to be made if sufficient capacity existed to support modem connections, increases predicted in export earnings averaged 0.74 per cent of current exports and were as high as 26 per cent for one company studied. The types of benefits to be gained included:

- Improved operational efficiency due to better access to suppliers;
- Ability to adjust sales prices rapidly in world markets due to better access to timely market information;
- Ability to decrease the number of sales lost due to the inability of customers to reach the firm or the firm to confirm reservations or co-ordinating services;
- Ability to expand sales more rapidly due to support for managerial sales efforts; and
- Savings in labour or management time due to an increase in call completion rates and a decrease in repair down-time.

The importance of state-of-the-art technology is emphasized by technological changes in the financial services field. Fault-tolerant computer systems like the Straus XA-2000 can provide customer-based, on-line, real-time transaction processing, with an integrated customer information file and ledger, using a voice prompt and phone keys for the customer's input. Any financial institution can use its telecommunications system link in, *if it is based on ISDN* (integrated services digital network), and get options such as financial services, customer services, or telemarketing via 800 numbers with credit-card verification.

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22 ITU, *Contribution of Telecommunications to the Earnings:Savings of Foreign Exchange in Developing Countries* (Geneva, ITU, 1988).

This type of computer service "infrastructure" is about to be launched in non-bank areas.[23]

In addition, cost structures are increasingly linked to the ability to automate and link world-wide such functions as inventory control, purchasing, trade documentation, and payment. Trade finance has lagged behind other financial specialities in automation due to its complexity. However, there are now five major trade finance software packages available in the Asian region for fully automated, on-line, real-time transactions - provided that the local telecommunications infrastructure can support the necessary data interchange.[24]

2. *Access to telecommunications services*

Access to telephones in China is still only 0.75 per 100 persons on average, and only 0.17 per 100 for the rural population. Although over half the population lives in rural areas, only 22 per cent of phones are located outside of urban areas and 55 per cent of the villages still have no phones at all. Only half of the provinces have any automated switchboards. Access to news is similarly limited. Only 9 per cent of the villages have access to a provincial daily newspaper the same day, rising to 15 per cent for towns and 34 per cent for smaller cities.

As of March 1989, China's Ministry of Posts and Telecommunications has announced cutbacks in telecommunications investment of up to 50 per cent over 1988, thereby limiting the competitiveness of firms internationally.[25] Taiwan, by contrast, has embarked on a four-year plan to develop expanded digital switching and data services as part of an ISDN to be completed by the year 2000.[26]

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23 See V. Lewis, "Talking to Alison", *The Banker*, January 1990, pp. 68-69.

24 See M. Roberti, "Trade Finance: Automation at Last", *Asian Finance*, 15 November 1989, pp. 82-86.

25 See J. Sprafkin and R. O'Brien, "Keeping Telecom on Hold", *China Business Review*, November/December 1989, pp. 24-28; K. Zita, "Telecommunications: China's Uphill Battle to Modernize", *China Business Review*, November/December 1989, pp. 18-24.

26 See R. Smith, "Taiwan Installs All-Digital Network", *Telephone Engineering and Management*, 1 September 1989, pp. 70-76.

In Korea, the Korean Telecommunications Authority (KTA) used the opportunity of the 1988 Summer Olympics to upgrade the telecommunications infrastructure significantly, and initiated with other Asian countries the first trans-Pacific fibre-optic cable system. Due to pressure from the United States to open its telecommunications market to foreign suppliers (particularly in the area of value-added networks), KTA is in the process of partially privatizing.[27]

3. Export opportunities in telecommunications

A wide range of trade opportunities exist in telecommunications given the present trends towards deregulation world-wide. For example:

- Singapore's telecommunications authority has developed a consulting arm to export its experience in developing and upgrading the telecommunications infrastructure.
- The Malaysian telecommunications authority could package and export its marketing and promotion programme for supplementing the rural telecommunications system with radio phones purchased by urban adults for their parents in the countryside.
- Portable E-mail and voice mail systems are gaining in popularity and could be adapted for internal firm communication in languages other than English.[28]
- Singapore could export its experience in developing on-line information systems such as videotex and POS with debit cards.
- In the United States market, videotex has not been popular due to the present relatively small base of final customers with PCs and modems. However, any firm able to design a system to market videotex systems to businesses in the United States could poten-

27 See "No Time for Compromise", *Business Korea*, October 1989, p. 46.

28 See "They're Here: Portable E-mail and Voice Mail", *PC Week*, 12 February 1990, p. 55. The system operates using a software package (System for Automated Messages - an E-mail package by TekNow of Phoenix) that transmits both to the network filer server and through modem to a local paging service.

tially be successful as such systems have proven successful for customer service support and expert advice.[29]

III. STRATEGIES TO INCREASE VALUE-ADDED SERVICE EXPORTS

In order to identify new opportunities in services exports, one must move beyond traditional concepts of new geographic markets or new service products for existing markets. The recognition that services may be traded through several modalities has helped, with UNCTAD identifying a range of possible forms of services export activity for developing countries.[30]

Simply listing possible new service trade opportunities is not very useful because of the rapid changes taking place both politically (in terms of available markets) and technologically (in terms of forms of service delivery). Rather, one needs a model of the types of services that can generate trade opportunities, with an understanding of the factors calling each type into play.

The choice of source and type of service to export is critical, particularly for smaller developing-country firms who could be facing stiff competition from large foreign competitors. Before exploring the major types of service exports, it is useful to understand that there are three general sources of service exports:

A. Sources of service exports

1. An existing service

If an existing service product can be adapted easily to other cultural environments, is computerized, has low telecommunication cost, and has a flexible cost-control system, then it can probably be marketed in other markets. For example, successful tourism services can often

29 See "Retailers and Videotex", *Stores*, February 1990, pp. 30-31.

30 See UNCTAD, *Services in the World Economy, op. cit.*

be extended to different client types such as health tourism, retiree relocation.

2. *Re-exporting a prior import*

One of the difficult issues in technology transfer between developed countries and developing countries is the "translation" that must occur in order for the technology to be suitable to a developing-country environment. Once the developing country (or developing-country firm) has invested time and resources in acquiring the technology, that technology can often be re-exported to another developing country as a less costly and more relevant alternative - as was formerly mentioned on the part of China vis-à-vis management training.

3. *Spinning-off efficient systems for export*

Particularly attractive systems exports are efficient versions of management systems that are used in virtually every country. Some examples include the management of petroleum extraction or phosphate mining.

As labour costs and the skill content of services rise, it is important to look beyond labour cost advantages to other, more stable sources of competitive advantage. Any developing-country firm with some sophistication in world markets should be able to capitalize on expertise in at least one of the following areas to help improve export earnings at least in other developing-country markets:

- Ability to work in less-than-optimal economic and social conditions;
- Similarity in cultural values and/or language;
- Experience with external funding sources;
- Experience in rectifying colonial distortions in service sector development;

- Experience in moving from a cash- to a credit-based society (more frequently now without the intervening step of cheque-cashing services);

- Experience in networking for business purposes among extended family and "overseas" communities; and

- Experience in developing professional associations, standards of practice, professional continuing education programmes.

Expertise can then be matched to appropriate geographic markets in order to determine export market priorities.

In analysing the different types of services emerging in the global market, one can differentiate at least seven types of services, each of which has particular characteristics that allow for a ranking by degree of value-added or profitability.

(a) Traditional services

These services comprise the classic national accounts structure (e.g. transportation, communications, wholesale trade, banking), and are typically offered as much to the final consumer as to other producers. Production may be quite labour-intensive, and value-added is typically low to medium. In developing countries, many of these services may be provided by government monopolies, which may themselves trade internationally, for whom profitability is not a driving motive.

(b) Business/professional support services

These services comprise the newer "externalized" producer services, most likely to be offered by private-sector firms (e.g. accounting, advertising, personnel provision, data entry). Here profitability is linked to the ability to create an efficient method for providing relatively routine operations and develop economies of scale. Skill level is on aver-

age, or more consistently, higher than that in traditional services - resulting in higher value-added.

(c) Innovative business services

These services develop out of the externalized producer services structure, once firms become used to the idea of contracting out service activities. The innovation may consist of specialization (e.g. acquisition of travel visas), a new service product (e.g. forms of electronic mail), or a new form of service delivery (e.g. 24-hour service or one-stop shopping). Skill level is moderate to high, and the added convenience to the customer is generally reflected directly in increased value-added.

(d) Service systems design/management

These services reflect another step in the differentiation of the service delivery process, with firms creating new service systems that they may manage or franchise (similar to a turnkey operation in manufacturing). A variation of particular relevance to many resource-based developing countries is that of spinning off the managerial expertise of a resource based industry (e.g. petroleum). Managerial expertise, often a scarce commodity in many developing countries, is key to the success of such ventures, and value-added is high.

(e) Change management in service systems

These services are derived from the common types of change being experienced in a number of countries - e.g. privatization, automation of goods production and structural readjustment. Such ventures depend for their success upon the ability to identify the keys to successful change and to generalize experience from one jurisdiction to another. Such speciality services are highly skilled and also highly profitable.

(f) Experiential edge in services

These services grow out of relatively unique experiences for which little expertise exists. Although such opportunities are not common, their very scarcity leads to high profitability for firms positioned appropriately.

Export competitiveness and growth depends upon the ability of firms to "move up" the value-added scale and identify niche markets in which they can compete successfully with the large multinational service firms.

B. Traditional services

In virtually every sector of traditional services, large international or transnational firms have emerged, with firms from developed countries usually dominating world markets. Several of the service sectors in which developing countries have been at least partially competitive, in addition to telecommunications (previously discussed) are discussed briefly below.

1. Construction

Growth in foreign construction contracts is finally improving after five relatively difficult years, though total contract values are still down. Korean firms, for example, experienced an average annual negative growth of 28 per cent between 1981 and 1988. The early lead by Korean firms, though, is instructive in terms of how export capacity can be built. Much of the expertise took place through technology transfer in joint ventures with foreign firms in the 1960s as the Government restricted foreign firms to a subcontract position with a Korean firm. However, a lack of market research and promotion skills has limited export growth outside Middle East markets until recently.

Domestic Korean construction orders for public sector projects are predicted to rise 40 per cent over last year, giving a much-needed

boost to the Republic of Korea's construction industry.[31] At the same time, however, over 900 new construction firms were created during 1989, increasing the competition for profits dramatically. After Korea's initial expansion of construction services abroad in the Middle East, little other foreign growth occurred. Now, however, Korean firms are participating in Siberian development projects, the Libyan Man-Made River project, and more frequent projects in the Asia-Pacific region.[32] As trade relations with the USSR normalize, increased opportunities may occur - e.g. both Samsung and Daewoo are pursuing hotel construction contracts.

Due to rising labour costs, Korean firms have been undergoing a shift from direct construction services to contract management, with the actual construction work subcontracted to Indonesian and Malaysian firms. Such a strategic move fits well with the overall international movement towards more sophisticated, and higher value-added, construction management services. China, on the other hand, has entered the foreign construction market at the lower-value-added end and had captured 2 per cent of the world market by 1987, with 70 firms worldwide employing 60,000 persons in 100 countries.[33]

2. Energy

The Asian Development Bank expects energy sector investment to average $19.4 billion per year between 1990 and 1995, with major demand coming from China.[34] China has significant reserves of coal, gas, oil, and uranium; however, export opportunities are constrained by inadequate transportation infrastructure.[35] For China, increased electrical capacity is a major priority for further modernization.

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31 See "Economic and Business Trend: Construction", *Korean Trade and Business*, January 1990, p. 9.

32 See Kim J.-M., "The Drought is Over", *Business Korea*, March 1990, pp. 81-83.

33 See *China Business Review*, September-October 1988, pp. 20 and 22.

34 See "Asia's Power Needs: Energy Investments Will Hit US$20 Billion a Year", *Asian Finance*, Vol. 15, No. 2 (1989), pp. 40-46.

35 See A.D. Owen and P.N. Neal, "China's Potential as an Energy Exporter", *Energy Policy*, October 1989, pp. 485-500.

Waste management is becoming a major issue in the region and any firm with an effective method of coping could be quite profitable. It is estimated that Hong Kong, Taiwan, and Korea intend to plan in excess of $5 billion for waste disposal over the next five years.[36] Both Japanese and United States firms are competing heavily for such contracts, which would include sewage treatment, recycling, and hazardous waste management, and joint ventures hold good promise for technology transfer.

3. Air transportation

Congestion at major airports is encouraging the growth of secondary airlines (e.g. All Nippon Airways of Japan and Asiana of the Republic of Korea).[37] Korean Airlines (KAL) ranked second in Asia in 1989, after Japan Airlines (JAL), tenth world-wide in passenger service, and sixth largest in cargo service. However, it is now having to compete against a second Korean airline - Asiana.[38]

Ancillary service export possibilities for both major and secondary airports would include crew training, equipment maintenance, baggage handling, meal service, aircraft cleaning, etc. With regard to episodic and predictable congestion, Malaysian Airlines, for example, has the possibility of exporting its organizational expertise for Hajj[39] charter flights to Mecca. Another example of export possibilities comes also from Malaysia - the exporting of maintenance services as is being done by Airod from Kuala Lumpur (in competition with regional repair centres in Australia, Hong Kong and Manila).[40]

Competitive pressures for consolidation continue to increase in computerized reservation systems (CRSs). For example, American

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36 See C. Goldstein, "Cash from Trash", *Far Eastern Economic Review*, 21 September 1989, pp. 80-81.

37 See "New Routes Will Develop to Meet Demand for International Service", *Aviation Week & Space Technology*, Vol. 130, No. 2 (1989), pp. 212-14.

38 See M. Clifford, "Absolute Beginner", *Far Eastern Economic Review*, 2 February 1989.

39 The annual pilgrimage of devout Muslims to Mecca.

40 See "Airod Expands Maintenance Capability to Attract Commercial Customers", *Aviation Week and Space Technology*, 6 November 1989, p. 63.

Airlines and Delta have merged their Sabre and Datas systems, and talks are continuing with foreign carriers wishing to join.[41] The Abacus CRS is based in Singapore, and involves Cathay Pacific, SIA, MAS, China Airlines and Philippine Airlines.[42] Airlines from developing countries need to select carefully the system(s) to which they belong. As a spin-off service, Garuda Indonesia could export its experience in switching to a computerized airline reservation system to countries not yet computerized.

Training of flight crew on new equipment is another growth area with export possibilities. For example, with regard to the provision of flight simulation training for the new B747-400s, Singapore Airlines has just installed a new flight simulator at its Flight-Crew Training Centre and could export such training. The simulator is the first of its kind in the world to provide training on B747-400s and to be designed to FAA Phase II performance standards.

Competitive changes are also occurring in air cargo and air charter. For example, Air France is bidding to become the leading air freight carrier, bypassing Japan Airlines and Lufthansa. Such a strategy would generate associated jobs in all "gateway" airports - and could be mimicked by a developing-country carrier such as Korean Airlines. Another type of export opportunity exists in relation to charter scheduling. Because of costliness of flying charters during the Hajj at 50 per cent load factor (empty return), any firm with effective capacity management skills could design a circular routing system that would fill those charter planes with cargo and/or passengers and then bid on the contract.

4. *Other transportation*

Urban transportation systems are typically overcrowded and under-maintained. In the United States in particular, older

41 See C.A. Shifrin, "American, Delta Computer Reservations Deal May Intensify Global Competition", *Aviation Week & Space Technology*, 13 February 1989, p. 94.

42 See Christopher Findlay and Peter Forsyth, "ASEAN Interests in Air Transport Services in the Uruguay Round", in *Services in Asia and the Pacific*, Vol. 1 (United Nations Publication, UNCTAD/ITP/51), p. 328.

infrastructure needs upgrading and ongoing maintenance - offering a number of export service possibilities.[43]

5. Banking

In *Fortune*'s 1989 listing of Pacific Rim banks, Japanese banks comprised 23 of the top 25 financial institutions. The Bank of China ranked No. 21 and was the most profitable of the top 25, with a 1988 net income of $1.1 billion. The assets of the top ten United States banks were only 30 per cent of the assets of the top ten Japanese banks. By 1989, Japanese banks accounted for 25 per cent of banking assets in California.[44]

Credit-card ownership in Asia has been growing at an average annual rate of approximately 30 per cent, offsetting the narrower margins of retail banking products.[45] In the Republic of Korea in particular, card issuance has been a major marketing tool, raising questions about market saturation and reserve levels.

With Korea's 1989 current account surplus, its banks are shifting their role from that of channelling foreign direct investment into the country to that of international syndications and investment abroad.[46] For example, the Korean Exchange Bank recently arranged a $140 million loan so that Korean Airlines could buy the Los Angeles Hilton.[47] In addition, Korean financial institutions have taken steps to establish trade financing facilities for Poland - with enormous potential waiting in the other Eastern European countries once Korea gains experience.

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43 See J.C. Szabo, "Our Crumbling Infrastructure", *Nation's Business*, August 1989, pp. 16-24.

44 See J.C. Viebranz, "The Top Banks", *Fortune*, Fall 1989, pp. 135-36.

45 See J. Friedland, "The Perils of Plastic", *Far Eastern Economic Review*, 19 October 1989, p. 50.

46 See "Korea: The Banks' Changing Role", *Institutional Investor*, November 1989, pp. 58-59.

47 See J. Evans, "Korean Exchange Bank", *American Banker*, 26 September 1989, p. 23.

6. Insurance

Global insurance premiums have been in excess of $1 trillion since 1987, at which time the top four markets in terms of volume were:[48]

United States	38.0 per cent of world market
Japan	22.5 per cent
Fed. Rep. of Germany	7.6 per cent
United Kingdom	6.0 per cent

The People's Republic of China represents the fastest growing insurance market, with real growth rate at 36.4 per cent. Although insurance premiums per capita were quite high for the Republic of Korea, there is still considerable lag in non-life policies - especially to the business sector. Considerable opportunities exist, especially in developing countries.

Hong Kong, a leading international financial centre, has a large cross-section of both international carriers (branch offices or subsidiaries) and local companies (domestic or regional). However, the local companies are at a severe disadvantage as they cannot compete in a global market where capitalization requirements are increasing. Over the next five years, industry concentration will be inevitable, with local companies being displaced or absorbed.[49]

C. Externalized business/professional services

The vitality and range of externally provided business services in an economy is increasingly central to its growth - both domestically and in terms of export earnings.[50] The development of competitive business services is directly linked to a country's overall development. In the Asia-Pacific high-growth countries, for example, business services grew

48 See "World Volume Tops $1 Trillion", *National Underwriter*, 11 September 1989, pp. 45, 50.

49 See D.G. Brock, "Pearl of the Orient?", *ReActions*, November 1989, pp. 42-44.

50 See UNCTAD, *op. cit.*

at a significantly higher rate from 1980 to 1985 than did any other industry sector.[51]

1. Types of business services

Business services perform two types of functions in an economy - competitive and innovative. Using externally provided business services can provide a variety of competitive advantages, especially for smaller firms, such as:

- The expenses for business service inputs become variable, rather than fixed, costs;
- Smaller firms have access to higher-quality business service expertise than they might be able to hire full-time in-house;
- Smaller firms have access to speciality services otherwise unavailable to them; and
- Small manufacturing firms with access to business service inputs are more successful exporters.

The type and quality of business services available to firms have a critical competitive impact as inputs for firms in all industries. Business services as a per cent of total Canadian corporate pre-tax expenses in 1985 ranged from 7 per cent for storage facilities to 57 per cent for advertising firms. In fact, the amount spent on externally purchased business services exceeded the corporations' expenses for wages and salaries in 44 per cent of the industry sectors.

Business services also serve the function of introducing structural, managerial, and technological innovations into an economy.[52] There-

51 See D.I. Riddle, "Issues Regarding Producer Services, With Special Reference to the Asia-Pacific Region", in UNCTC, *Services and Development: The Role of Foreign Direct Investment and Trade* (United Nations Publication, Sales No. E.89.II.A.17).

52 See W.Z. Michalak and K.J. Fairbairn, "Producer Services in a Peripheral Economy", *Canadian Journal of Regional Science*, Autumn 1988, pp. 353-72.

fore, the development of business services can act as a driver for growth by:

- Integrating different sectors of the economy efficiently (e.g. employment services);
- Initiating and facilitating soft-technology transfer (e.g. management consulting);
- Creating technologically innovative methods of doing business (e.g. computer services); and
- Generating export activity and revenues.

Business services are responsible not only for firms' global competitiveness but also for their ability to stay at the leading edge of their markets. Most business services depend for their success upon one or more of the following competitive strategies:

- Price competition through a standardized delivery system that achieves cost economies in an already available service;
- Niche market strategies through delivery of a modified service to a market segment too small to attract large international competitors;
- Introduction of a franchised service to a new market;
- Commercialization of research/laboratory results;
- Quality positioning through quality control and service bundling of already available services that allow for pricing premiums; and
- Spin-offs of an existing managerial system that:

  (1) provides significant cost and/or quality control,

  (2) effectively manages costly externalities, and

  (3) provides product support services (such as R & D; maintenance).

All of the above strategies can be implemented by either service or goods-producing firms. For example, there is a manufacturing process,[53] involving the computerized delivery to the plant floor each day of exactly the number of components which must be assembled before workers can leave, which could be exported as a service system.

2. *Exporting business services*

A recent Canadian study[54] indicated that 11 per cent of domestically produced business services were exported (more than double that of services on average), accounting directly for 45,000 jobs and spurring an annual growth rate of new-job creation of over 7 per cent. With approximately half of the services sold in developed countries being producer/business services,[55] it is most likely that new opportunities for service exports would be concentrated in business services.

Not all business service systems are candidates for exporting, especially if they cannot be adapted to varying cultural and business environments. Export ready firms, regardless of size, are those with an appropriately flexible cost structure and plans for controlled growth.

In key-business services, mergers and acquisitions have resulted in tremendous consolidation. Developing-country firms must now compete against large multinationals with scales of economy and scope. Alternatively, they may join the networks and enjoy the scale economies, technology transfer, and name recognition that can accompany membership in a global service enterprise.

In advertising, for example, expenditures in Asian developing countries have been increasing rapidly creating consumer demand for more sophisticated products (especially services). Singapore has the highest density of agencies in the region and will experience relatively

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53 Developed in the Federal Republic of Germany as part of a programme to boost productivity.

54 See Economic Council of Canada, *Good Jobs, Bad Jobs* (Ottawa, ECC, 1990).

55 Based on estimates by Industry, Science and Technology Canada in 1989. For the Canadian economy, the other 50 per cent of services produced were half for the public sector and half for the final consumer.

little growth, but most other markets should be high-growth markets. China, Republic of Korea, and Taiwan show particularly high-growth potential.[56]

Korea's advertising industry has continued healthy growth, due in part to Government liberalization of restrictions for the Olympics. Distribution services ranked fifth for 1988 in Korean advertising spending - the first service industry to enter the top ranks. Indeed, 24 per cent of the spending in the top 10 categories was by service firms.

Of the 12 recognized advertising agencies in Korea, nine are owned by one of the conglomerates. Korea First Advertising, the top-ranking agency, is owned by the Samsung Group.[57] Such affiliates are buffered from some competitive pressures by contracts from the various business groups within the conglomerate (comprising 46 per cent of billings) and by the financial resources of the parent group.

Any number of possibilities for contracted-out business support services exist so long as the telecommunications infrastructure is high-quality and priced competitively. An interesting new possibility is that of bidding for the development of the upcoming global directory for E-mail since standards like the Consultative Committee on International Telephone and Telegraph's (CCITT) X.400 message-handling system are making network interconnections and communication between differently formatted databases possible. Other types of contracting out include:

- Contracting for routine, labour-intensive support services such as Check clearinghouse, Information processing, Transaction processing, Telemarketing, Mail-order, Frequent flier programmes, Credit-card transactions, Insurance claims, Security checks, Title searches, Probate procedures, and Building/updating data bases;

- Contracting for research on Marketing, Legal issues, Consulting, Creditworthiness, and Software development; and

- Contracting out to track maintenance schedules.

56 See J.S. Hill, "International Profiles: Asia's Little Dragons", *Advertising Age*, 9 November 1988, pp. 104 and 106.

57 See "Advertising and Media", *1989/90 Business Korea Yearbook*, pp. V1-V8.

Positioning in the offshore provision of such services needs to be carefully researched, however, as some export opportunities have more growth potential than others. For example, while data processing offshore has been popular particularly in the Republic of Korea, the Philippines, and India, bar codes and increasingly sophisticated optical scanners are significantly reducing the amount of manual input needed. Electronic messaging services are a higher potential growth area.

An alternative strategy is that being pursued by Thailand in establishing an independent data-processing zone with international direct satellite linkages.[58] The two State communications agencies will be bypassed, not boding well for domestic development but certainly making the arrangement more attractive to foreign investors.

D. Innovative business and personal services

Regarding innovation in service delivery, almost anything is possible. For example, Family Trust Real Estate in Toronto has developed and installed a low-frequency radio transmitter in houses for sale that "speaks" to persons parked in cars up to 500 feet away, detailing the home's special features.[59] British Airways is experimenting with personal in-flight video systems for its first-class passengers.[60] Clean Cemetery Co. in Japan visits and cleans graves.[61] Scandinavian Airlines System is promoting a computer system that allows airlines to track equipment maintenance requirements.[62] Any of these services can be exported beyond a domestic market.

One type of innovative service creates a "virtue" out of economic difficulties. For example, Arthur Andersen and China International Economic Consultants have instituted "corporate recovery" ("company

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58 See P. Handley, "Bangkok By-pass", *Far Eastern Economic Review*, 5 January 1989, p. 60.

59 See B. Brown, "Family Trust Lets its Houses Speak for Themselves", *Adweek*, 18 September 1989, p. 52.

60 See "Personal In-flight Videos" *Middle East*, August 1989, p. 35.

61 See "Visiting Graves New Service in Japan", *Globe and Mail*, 3 January 1990, p. B18.

62 See A. Reed, "Marketing a Monitor for Maintenance", *Air Transport World*, September 1989, p. 122.

doctor") services for less-than-successful joint ventures in China,[63] which assist in determining the reasons for difficulties and making recommendations for recovery.

Another general type of innovative service is the integrated service system, or "one-stop shopping." A relatively early example was the creation by the United States car manufacturers of in-house credit companies to provide purchase financing - with General Motors soon becoming one of the nation's largest mortgage companies.[64] Ports have begun establishing in-land port facilities to take delivery and management of shipments at an earlier stage.[65] Facilities management is part of the same phenomenon - an ever widening range of responsibilities.[66]

E. Service systems design/management

A less frequent form of export that deserves more attention is that of systems that have been developed to manage service delivery particularly effectively. For example, Singapore Airlines has developed a superb crisis-management system that could be exported not only to airlines but also to other types of transportation companies. Similarly, Changi airport in Singapore could export its expertise in assuring rapid baggage handling regardless of flight size or airport congestion.

With quality control in services gaining considerable attention, any business service firm with a good quality-control system could export that system as a franchise chain. In addition, attention is now being paid to the "micro-management" of service firms - offering opportunities for export of expertise to firms with well-developed management systems in place.[67]

As populations grow and pressure on urban systems increases, techniques are needed for effective crowd management. For example,

63 See "Corporate Recovery: Company Doctors Call on China", *Asian Finance*, 15 June 1989, p. 11.

64 See L. Nathans, "And You Thought They Just Sold Cars", *Business Month*, November 1987, pp. 42, 44, and 48.

65 See M.E. MacDonald, "Ports Look Inland for New Business", *Traffic Management*, November 1989, pp. 47-50.

66 See J. Lamacraft, "A Facility for Change", *Management Today*, July 1989, pp. 91-98.

67 See "Serve Them Right", *Economist*, 5 May 1990, p. 79.

Indian firms could export the expertise of managing up to 10 million at the bathing ghats in Allahabad during religious festivals.

F. Change management in service systems

Several types of change are being faced world-wide, and firms with successful experiences can create export opportunities for expertise in managing situations of change. For example, a number of publicly held agencies are being privatized, some industries are being deregulated, and in-house services are being spun off as independent ventures.

Another type of change involves the integration of computer technology. For example, fast-food chains are replacing POS registers with PC-based registers linked to 386s and dumping to central database with AI-based ordering systems for inventory control and more efficient delivery, providing consulting opportunities.[68]

Many smaller firms are facing competition from service transnationals for the first time, with little experience in exploring competitive options. Any firm successful in creating a viable network of independent firms to achieve competitive economies of scale and scope could export such a system.

G. Experiential edge in services

Several examples already exist of services developed under a specific set of circumstances that could be packaged and exported as appropriate. Typically, relatively unique circumstances create high R & D service systems costs so that, once a successful service has been developed, it can command a premium price with little competition. For instance, the first computerized on-line library system for Chinese higher education has been developed for the Pao Sui-Loong Library at Shanghai Jiao Tong University (one of China's best engineering schools), integrating Chinese and foreign-language entries for both circulation and on-line information retrieval systems.[69] Such a system could be exported to any Chinese-language-based institution abroad,

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68 See D. Eskow, "Wendy's Turns to PCs to Beef up Operations", *PC Week*, 12 February 1990, pp. 121 and 124.

69 See S.C. Lin, "Shanghai Jiao Tong University Pao Sui-Loong Library: Toward an

as well as serving as a model for how to computerize mixed-alphabet systems.

Another example is the expertise gained by a country like Korea that has hosted the Olympic Games. As preparations for the Olympics in Barcelona appear to be running into difficulty, there should be a host of consulting or subcontracting opportunities for Korean firms. There may also be specific spin-offs of the Olympic experience that can be exported - for example, the mobile pay-phone system developed.[70]

IV. POLICY ISSUES IN DEVELOPING NEW SERVICE EXPORTS

The global market in services is rapidly expanding and becoming more complex. The traditional distinctions between service industries (as well as between services and goods) are breaking down, particularly in developed-market economies. Accounting firms have already diversified into management consulting and computer information systems, with banks now following a similar trend in the United States market. Major financial commodities are offered not only by banks but also by major retailers. The lines between computer, information, fax, electronic mail, videotex and traditional telecommunication services have blurred. With so many changes occurring, developing-country firms face both opportunities and challenges.

A. The relevance of global industry structure

As the Uruguay Round draws to a close, some form of multilateral agreement to liberalize services trade appears likely. The impact for developing countries is not clear, and the relevance of global industry structure to development strategy cannot be overlooked. Given the increasing consolidation through mergers and acquisitions, an increasing number of professional-service industries world-wide are now dominated by a handful of STNCs. In fact, the size of some of the major

Integrated On-line System", *Information Technology and Libraries*, March 1989, pp. 63-68.

70 See "Mobile Pay Phone Service at the Asian Games", *Far East Business*, November 1986, p. 25.

service conglomerates is a major issue in market control. The top accounting firms, for example, average 281 affiliates world-wide.[71] They have gross revenues in excess of the GDP of a number of smaller developing countries, and they posted a higher revenue output per worker in 1987 than did Switzerland.[72] Some industry analysts are predicting that in services where technological changes provide an important competitive edge (such as telecommunications), a successful international service firm will need to control 20 per cent of the world market - leaving room for only five major players world-wide.

In addition to their market dominance in their primary line of business, such STNCs have the resources to diversify into both new products and new lines of business, cross-subsidizing initial losses. The ability to introduce new services or innovations in service delivery is crucial in remaining competitive. Services and their delivery systems cannot be protected by patent. Therefore, industry leaders must be constantly innovating in order to maintain their lead.

From experience to date and in the light of pressures towards trade liberalization, several possibly concurrent trends can be predicted: (1) an increase in joint ventures between STNCs and local developing-country firms; (2) an increase in STNC across-the-border trade, with a consequent decrease in positive multiplier effects within the developing-country economy; (3) an increase in affiliates of STNCs concentrated in larger developing-country urban centres; and (4) an increase in regional developing-country STNCs. While the positive consequences of STNC presence - in terms of technology transfer and provision of world-class services - are widely known, some of the potentially negative consequences are not as well known. Those potentially negative consequences are detailed below in order to assist governments in developing policies that are more likely to facilitate positive rather than negative consequences.

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71 Calculated from data in UNCTC, *Foreign Direct Investment and Transnational Corporations in Services* (United Nations Publication, Sales No. E.89.II.A1).

72 See data in D. Riddle, "Issues in Trade Liberalization of Producer Services for Developing Countries", paper presented at the Yugoslavian National Seminar on Services in the Context of Ongoing Negotiations in the Uruguay Round, organized by UNCTAD in Belgrade, September 1989.

1. Joint ventures between STNCs and local firms

Joint ventures have occurred for a variety of reasons - e.g. statutory requirements by the host country regarding ownership, statutory requirements by the host country regarding citizenship as a requisite for professional licensing, and enhanced access to the domestic market. Issues of concern to developing countries have focused around the degree of managerial control accorded to nationals and STNC head-office requirements regarding the importation of key business services.

Well-managed, such joint ventures can provide both the needed expertise and global recognition for developing-country service firms. A key, drawing from the Korean construction experience, appears to be ensuring that the developing-country firm is in the lead position.

2. Sourcing of services from STNCs across borders

In the debate over liberalization of market access, it is often assumed that restricting market entry will eliminate competition from foreign-controlled firms. That may be the case in the short run, but in the long run - as regulatory environments ease - services may be traded *more* efficiently over the border from a centralized head-office facility. For example, Lloyd's of London provides insurance coverage of many types through affiliate agents in a number of national markets. Technologically, there is no reason why Lloyd's could not bypass national agents and offer its services to subscribers directly through videotex systems or even by correspondence.

While branch offices of STNCs may create less-than-optimum multiplier effects in a local market, across-the-border trade provides even fewer multiplier effects. Presumably, some affiliate relationship would be maintained in order to handle problems needing personal attention, but the financial benefits of the relationship could be kept to a minimum.

STNCs most able to trade services across-the-border would be those that already enjoy name recognition and regional or international reputation for reliability. Clients most likely to contract for across-

the-border services would be those at the more profitable end of the market - foreign firms, medium or large-size national firms, and well educated and wealthier final consumers. National developing-country firms with little visibility outside of their home markets would be hard pressed to compete effectively for business from even that part of the domestic market.

3. Affiliates of STNCs in larger developing-country cities

In several service industries, such as accounting and banking, the major STNCs already have some form of commercial presence in at least the capital cities of most developing countries. On the positive side, the presence of major STNCs in developing-country markets makes it possible for developing-country firms competing internationally to have access to world-quality service inputs. In addition, STNCs can serve a useful development function in the transfer of soft technology and the training of developing-country nationals in world-standard business practices. But there are several clear costs that may occur:

- *STNCs may capture local MTNC and STNC business.*

  The STNC typically enters the developing-country market because major MTNC and STNC clients are already present, making it less likely that developing-country firms can service the MTNC and use that commercial relationship to launch export activity.

- *STNCs may displace potential developing-country exporters.*

  The STNC typically targets the higher (and more profitable) end of the domestic market, leaving the less profitable business to local firms and making it more difficult for the local firm to develop the type of market base necessary to launch export activity.

- *STNCs may provide little revenue to developing-country business service firms.*

The STNC typically sources its business support services through its head office in order to achieve economies of scale, making it unlikely that local developing-country business service firms would acquire spin-off business.

- *STNCs may provide little export revenue.*

The STNC typically targets the domestic market and exports primarily from its head office,[73] thus reducing potential export earnings for the developing country.

- *STNCs may provide little employment growth.*

While STNCs hire locally when the branch office is set up, a lack of export revenues typically results in a lack of local employment growth.

- *STNCs may contribute to "brain drain".*

When STNCs hire locally in a developing-country market where the number of highly skilled service workers is low, not only may they "corner" those scarce resources but they may also then transfer them outside the country to other parts of the STNC.

- *STNCs may contribute to regional disparities.*

STNCs tend to concentrate in larger markets, attracting to them other larger client firms,[74] with little interest in establishing in smaller communities without a base of potential foreign-firm clients. As a result, the disparity between large urban centres and smaller towns and villages with regard to employment opportu-

73 For United States STNCs, for example, the export intensity of affiliates was only 23 per cent in 1982 (UNCTC, *Foreign Direct Investment and Transnational Corporations in Services, op. cit.*) Another way of stating the same issue is that a number of STNCs engage in restrictive business practices by requiring that potential work in a foreign market be referred to the corporate office in that market (e.g. a Malaysian firm approaching the Singapore branch office would be referred to the branch office in Kuala Lumpur).

74 See W.J. Coffey, "Structural Changes in the Canadian Space-Economy, 1971-1981", in W.J. Coffey and M. Polese (ed.), *Still Living Together: Recent Trends and Future Developments in Canadian Regional Development* (Montreal, IRPP, 1987), pp. 73-120.

nities and economic growth may be heightened, leading to additional pressure on the urban centres.

4. *The role of regional developing-country STNCs*

Within developing-country markets, an increasing number of examples exist of firms that have a diversified services base. For example, Sinobrit Ltd. in Bangkok is the general sales agent in Thailand for Northwest Airlines, specializes in information technology and radio communications, provides industrial and commercial engineering services, and through subsidiaries operates tours (Sinobrit Agencies Ltd.), provides insurance (Thanya Phanich Ltd.), and acts as the general sales agent for Lauda-air (Chaiya Transair Ltd.). A major goods-producing company in the Republic of Korea such as Daewoo also has affiliates in construction, financial services, quality-control services, telecommunications, and hotels.

5. *Implications for developing-country governments*

While each of the above trends posits some positive consequence for the developing country, none of them predicts a significant increase in market share captured by developing-country service firms. In arguing for the liberalization of market access for foreign service firms, the point is frequently made that the range and quality of key business-service inputs is crucial to ensure the competitiveness of national firms in global markets.[75]

One is confronted, then, with a situation in which a conflict of interest exists between various constituencies in the developing economy.[76] Local firms that would benefit from foreign-sourced business-service inputs, or who wish to partner with the foreign business-service

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75 See, for example, data on the increased export success of small manufacturers with access to quality business-service inputs (A. MacPherson, "Industrial Innovation and Technical Service Linkages: Empirical Evidence from Toronto", *Environment and Planning*, 1988, pp. 466-86.

76 See D.I. Riddle, "Issues in the Trade Liberalization", *op. cit.*

firm, may argue for more liberal market access. Local firms competing at a disadvantage with the foreign business-service firm (with regard to scale economies and the ability to cross-subsidize new service products) may argue for restricted market access. Governments concerned with stimulating export earnings and generating more jobs may find themselves torn between policy initiatives that ensure world-class business service inputs but little growth in export revenues or job creation, or initiatives that protect national firms at the expense of the overall economic growth deriving from healthy export earnings.

B. The relevance of national industry structure to development strategy

Both within economies and across economies there is a great deal of variability in the structure of various service industries. In some instances, the industry is "fragmented" - i.e. composed of a number of small family operations much like cottage industries. Such firms typically have acquired few scale economies and are relatively unsophisticated in market-research techniques. Many of these firms depend upon location for their clientele, remaining profitable primarily through low overhead and "donated" family labour. Instances would include not only small retailers but also industries like the "nascent" computer services industry in Indonesia. The impact of market entry by a sophisticated national or multinational firm can be devastating as the small firms cannot afford the ensuing competition in price and range of services. If such cottage industries are to have an opportunity to develop into internationally competitive firms, they must have some protection from immediate direct competition while receiving skills upgrading.

Alternately, there may be present in the developing-country market national private sector firms that have developed some economies of scale and sophistication in marketing but not yet created the types of international linkages necessary to compete globally. While such firms can compete effectively with other national firms and may even be able to hold their own against STNCs, they are typically eager to link with STNCs in order to develop an international presence. Advertising in India illustrates such an instance. Immediate liberalization of market access for STNCs may place such national firms at a clear disadvantage but coupling market access with requirements or in-

centives to form joint ventures can be quite beneficial. Strategic procurement can also be used to help "grow" such domestic firms and launch them internationally.

Certain infrastructure and financial industries typically develop as national monopolies or highly regulated private sector firms. If that monopoly firm (or firms) has not diversified into other services, it probably lacks experience in developing economies of scale or scope or in competing directly on price or quality even if it has some international presence. Insurance in India would be a case in point. Immediate liberalization of market access for STNCs could be fiscally devastating; however, a staged liberalization that begins with careful deregulation within the national market can set the stage for productive competition.

In other markets, such as the Republic of Korea, a series of large, diversified firms have developed historically a dominant share in the market. Such firms typically are already competing in world markets and have the skills and resources to compete directly with STNCs. Developmentally the issue becomes the priority placed on encouraging the growth of independent small and medium-size firms. Given the concentration of conglomerates, there is typically little client base left to spur the growth of smaller firms. If such a priority exists, it can often be met by requiring that certain business support services be contracted out to those smaller firms - by both national and foreign conglomerates.

Finally, there are markets in which free enterprise has not been a tradition and where government monopolies control most of the economy. Such is the case in the People's Republic of China. Diversification again has taken place primarily within the existing monopoly unit. While entrepreneurial export activity may be unlikely, "intrapreneurial" innovation and initiative can be encouraged.

One can see from the preceding discussion that no single trade policy regime would ensure development objectives given the diversity of industry structures. If development concerns are to be addressed, developing-country governments must have available to them a range of policy instruments.

V. DEVELOPING SUPPORT FOR DEVELOPING-COUNTRY SERVICE EXPORTS

The balance between government and private sector initiatives in trade is a delicate one. To ensure competitiveness in global markets, private sector firms need to face the pressures of competition first in their home markets where they are best equipped to improve scale economies and home managerial and marketing skills. Thus, government initiatives that intervene unduly in the market - e.g. by trying to select "winners" - are unlikely to prove successful.

However, given the size of major STNC competitors, strategic government assistance is critical to export success. Realistically, export activity does not usually begin by a new firm launching a new service in a foreign market. Typically, the firm needs to develop a strong domestic base that can sustain it through the vicissitudes of global competition.

There are at least two methods by which firms can gain expertise in dealing with foreign clientele while remaining in their home market - providing services to foreign firms established in the domestic market and providing services to foreign firms wishing to enter the national market. In addition, valuable experience in co-ordination of service provision can be gained by providing service "exports" to other regions of the country - as demonstrated by the experience of Seattle, United States - and through regional co-operation in selected services.

A. Strategies involving domestic policy

In developing countries in particular, the government has two major roles in assisting firms to expand exports. The first role relates to the domestic policy environment in which firms must operate. In a study underway of Canadian service exporters, internal barriers (such as access to growth financing and air transportation schedules and costs) were cited as creating more problems than external non-tariff barriers.[77]

77 Study being conducted for Industry, Science and Technology Canada by the Canadian Exporters Association.

1. Develop policies targeting services

Typically, the service sector has been accorded various forms of benign neglect. Traditional economic-development theory has assumed that services growth will automatically follow the growth of manufacturing, with the growth of goods production spurring the growth of services. Input-output data, however, indicates that the interlinkages are more complex. By 1975, services were important inputs not only to goods-production but also to service production. In fact, as value-added increases, the relative percentage of service inputs also increases. By 1984, services were averaging well over 50 per cent of industrial inputs in the OECD countries.

Therefore, governments need to develop proactive economic development policies targeting the service sector in general and business services development in particular. Such programmes could include assistance for purchasing external professional expertise (e.g. marketing, management consulting), loan guarantees for successful service firms needing additional working capital but without "hard" assets against which to borrow, retraining funds for goods-producing workers hired into the service sector, etc.

2. Ensure quality infrastructure

The importance of quality telecommunications infrastructure has already been discussed at length. Quality transportation services are also important, both for the movement of people and the movement of goods. Air transportation needs to ensure direct, frequent, dependable, and cost-efficient access to key international markets.

Port facilities need to incorporate state-of-the-art technology. The competitive positioning of ports is increasingly dependent on the direct provision of value-added services such as warehousing, labeling, packing, repacking, cargo consolidation, inventory management, order

filling, and final assembly.[78] At the technological cutting edge is the integration of EDI (electronic data interchange) with all aspects of port facilities, as is being proposed by Tradelink for Hong Kong.

3. *Institute changes in tax structure*

Typically, investment tax credits have been developed by governments to encourage goods producers to invest in fixed capital equipment. For service firms, however, upgrading worker skills is a major area in which investment is needed, along with the integration of computer technology into the work place. Investment tax credit needs to be available for investment in telematic technology and development of human resources.

B. Strategies involving trade infrastructure

The second crucial role played by governments is that of providing a trade marketing infrastructure through the network of embassies and trade office abroad. Especially for smaller firms that cannot afford a network of world-wide affiliates on the scale of large STNCs, the support provided by governmental agencies is vital to success.

In implementing the two major roles discussed above, there are six different strategies of importance to the success of developing new service exports:

1. *Encourage entrepreneurship*

New service opportunities are most likely to be identified and developed commercially by entrepreneurs. The actual entrepreneurial "event" is an action taken by an individual or group of individuals who have a vision of a different way of doing business. Entrepreneurs differ significantly from business managers or administrators.[79] While man-

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78 See H.L. Richardson, "Ports Increase their Value-added Services", *Trade and Development*, September 1989, pp. 30-32.

79 See H.H. Stevenson, M.J. Roberts, and H.I. Grousbeck, *New Business Ventures and the Entrepreneur* (Irwin, 1985).

agers are constrained by resources, entrepreneurs are not - they assume that they will be able to find the necessary resources. Rather, the entrepreneur is driven by the perception of an opportunity.

Because entrepreneurs are opportunity driven, the mere allocation of resources or designation of funding will not create effective new businesses. But, although that "event" cannot be precipitated by public sector policies, its occurrence and likelihood of success can be enhanced by targeted government actions.

2. Provide appropriate incentives

In developing incentives, it is crucial to identify the purpose to be achieved. Simply providing tax incentives will not necessarily stimulate export growth.[80] Incentives need to be tied to demonstrated export performance if export growth is to be achieved. Similarly, loan guarantees for service firms with few "hard" assets could be tied to export performance.

3. Develop networked environments

To assist firms in keeping costs low and developing synergy with other firms, the government can assist in establishing "incubators" for growing service exporters (perhaps within the context of a World Trade Centre) where the expense of various support services can be shared. Similarly, a business support services infrastructure could be created parallel to another government institution that is frequented regularly by citizens (e.g. post office, public library), which could include fax, copier, phone answering, etc.

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80 For example, Singapore instituted a campaign in 1985 to attract regional headquarters of STNCs. It was very successful, but a result was negative growth in service exports due to the restrictive business practices cited earlier. The trend reversed when incentives were tied to a performance requirement regarding a percentage of export revenues.

4. Utilize strategic procurement

To help national service firms develop both the capacity and visibility necessary to move aggressively in export markets, the government and its embassies could purchase from national firms that had demonstrated export growth and/or the implementation of a quality-control system. For example, the awarding of large construction contracts to domestic firms (with foreign subcontractors if necessary for expertise) can help build scale economies. Similarly, the use of locally owned advertising firms by government departments can help develop a competitive capability for the local firms.

5. Provide export assistance programmes

Programmes need to target the real needs of services exporters in developing new markets, particularly the funding of repeat visits to develop a network of contacts and referral sources. Information needs to be collected and disseminated on a timely basis. Trade officers need to be trained to identify relevant market intelligence and to disseminate it widely and rapidly.

6. Develop one-stop service export support

Typically, many of the developing-country service firms are small in size and have few marketing resources. Specifically, they generally do not have the personnel to canvass all prospective government support agencies. Creating a "one-stop" service export support system can help smaller firms use their time to the greatest advantage. Such a service could be keyed around a directory of service exporters, plus an export hot-line over which to receive immediate market intelligence (perhaps again in conjunction with a World Trade Centre).

VI. MECHANISMS TO "LEVEL THE PLAYING FIELD"

The task of encouraging increased service exports is difficult but not impossible. In an environment of increasing consolidation and concentration of developed-country firms, developing-country service exporters face several basic problems:

- Lack of same-scale competition in their home markets.
- Lack of demand for quality services, resulting in mediocre quality control.
- Lack of a ready-made client base in export market (similar to the TNCs for STNCs).
- Lack of name recognition in global markets.
- Lack of "country of origin" image assistance.
- Barriers to foreign travel in order to develop contacts (both visa and currency restrictions).
- Lack of skilled personnel.
- Lack of experience in a highly-competitive foreign market.
- Lack of domestic demand for innovative services.
- Lack of marketing experience.

Much has been made in the Uruguay Round, particularly by the United States, of the concept of a "level playing field" where all participants have an equal opportunity to compete. Such a concept requires that participants either begin from the same industry structure position (patently impossible given the dominant market position of many of the United States STNCs) or be granted special privileges or incentives that equip them to compete effectively.

A. Policy mechanisms and export activity

One of the complications for policy makers with regard to services trade is that the needs of various types of service vendors are not the same. For exporters of traditional and business services, cost control is critical and thus unrestricted access to resources is also critical - including the ability to move staff freely across borders and receive national treatment. For innovators and systems designers, export incentives become important to help build critical mass in a new field. Those exporting highly specialized expertise, on the other hand, can command a price premium, and customer demand for their unique services can help guarantee market access.

It is apparent from the above analysis that it is the lower value-added, less highly skilled services that are most likely to be affected by the outcome of the Uruguay Round negotiations. Firms offering the relatively unique, high value-added services are unlikely to have any major problems accessing clients. Their needs for specialty training in market research and managing innovation as well as market intelligence can be addressed by domestic governments without reference to trade policy.

B. Selection of appropriate policy initiatives

Four types of initiatives are proposed for adoption in order to create a more equitable competitive environment - unrestricted temporary labour movement, "border" performance requirements[81] of foreign governments and firms in order for those firms to qualify for national treatment within the developing country, targeted incentives, and developing-country firm training programmes provided through the auspices of UNDP. Each of the initiatives proposed is linked directly to a particular advantage now enjoyed by STNCs.

81 Border requirements could include various performance requirements such as local content and export performance in order to ensure multiplier effects for the local economy. Such requirements would form a precondition for commercial presence of a sort that might qualify the firm for national treatment.

1. Unrestricted temporary movement of workers across borders

One of the competitive traits of STNCs is their network of affiliates world-wide that can provide them with contacts and market intelligence. Developing-country firms typically lack such extensive networks and must depend upon personal visits to foreign markets. Visa restrictions in developed-country markets create a major obstacle to timely entry.

2. Performance measures

STNCs are in a position to select competitive business service inputs from an array of offerings world-wide and typically consolidate such purchases through their head office. Developing-country firms, on the other hand, are usually restricted to locally purchased inputs. Developing-country business service firms are further disadvantaged if STNCs play a major role in their markets as it is difficult if not impossible to acquire STNC affiliates as clients if purchasing is centralized. Developing-country governments can assist local firms through incentives for contracting out coupled with "border" performance requirements for the STNC regarding local content.

3. Targeted incentives

STNCs also command a large and extensive client base world-wide, coupled with name recognition on the part of potential additional clients. Developing-country firms typically lack both the broad client base and the extensive name recognition. To help build the visibility of developing-country firms in the global market, developing-country governments should be able to implement strategic procurement policies favouring locally-owned firms.

Availability of growth capital is a major issue for service firms, which typically lack the tangible assets necessary to secure financing for

growth.[82] For profitable STNCs, growth capital can be made available from financial reserves within the company in the form of cross-subsidization. Developing-country governments, therefore, need the right to provide loan guarantees to service firms and restrict those guarantees to national firms.

4. *Training programmes*

In order to increase the value-added potential in exported services, three types of training programmes could be mandated for developing-country firms: (a) market research skills; (b) systems management and design; and (c) managing innovation.

VII. CONCLUSION

Increasing service exports from developing countries is important not only because of the generally positive multiplier effects from higher export earnings but also because of the higher value-added (and hence greater domestic spin-off) in services as compared with goods production. If developing countries depend upon STNCs for the promotion, distribution, and financing of their goods exports, the earnings gap between developing countries and developed countries will continue to widen. If on the other hand, developing-country firms can provide not only the value-added services for goods exports but gain market penetration in service exports themselves, the gap could begin to narrow. The key to increased service exports lies in government's support of the type of innovation and entrepreneurial activity necessary to develop high-value-added service exports.

82 For Canadian corporations in 1985, the percentage of total assets that constituted "hard" assets against which a financial institution might lend was 63 per cent for extractive firms, 56 per cent for manufacturing firms, and only 26 per cent for service firms (calculated from *Canadian Corporate Statistics*, 1988).

STATISTICS ON SERVICE TRADE IN ASIA

*Mária Dunavölgyi**

INTRODUCTION

The present paper attempts to describe the state of statistical activity on service trade in the following countries and territories: Republic of Korea, Hong Kong, Thailand, Singapore, Sri Lanka, and India. The paper addresses the primary information sources used for data on international service transactions, the data collection systems, the scope and coverage of statistics, and the breakdown applied. The paper also attempts to place these practices to the current attempts at the international harmonization of service trade statistics.

I. CONCEPTS AND DEFINITIONS

International trade in services can be defined several ways since there is no generally accepted definition for this term. For the purposes of this paper, the concepts and definitions employed are those recommended by the United Nations Statistical Office (UNSO) and the International Monetary Fund (IMF). The concepts of "goods and services" and "resident economic unit" of the United Nations System of National Accounts (SNA) and the "current account" of IMF *Balance-of-Payments Manual* (BPM) are relevant here. Though there

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* The author is an associate statistician at the United Nations Statistical Office, New York. This paper is based on the preliminary results of study carried out in cooperation with UNCTAD and ESCAP. The author is grateful to Mr. S. Base and Mr. J. Kumar of ESCAP who accompanied her on a series of country missions used to gather the information published here. The author is also grateful to the national officials of Hong Kong, India, Korea, Singapore, Sri Lanka and Thailand who took time out of their busy schedules to provide extensive information about national practices in their countries as well as the IMF and UNCTAD for the help provided. However the views expressed in this paper are sole responsibility of the author and do not necessarily reflect those of the United Nations.

are some differences between the latest edition of BPM (fourth edition published in 1977) and the present SNA (issued in 1968), most of the conflicts seem to disappear, thanks to the recent methodological improvement and harmonization work.

According to the above-mentioned sources, international trade in services reflects transactions between resident and non-resident economic units. Trade in services in SNA are transactions in items other than goods (other than merchandise) which are still within the category transaction in goods and services. The current account of the BPM fourth edition reflects also transactions between residents and non-residents - not only those in goods (merchandise) and services, but also those in labour and property incomes (which are called factor incomes), together with unrequited transfers. All of these items, excluding merchandise, are sometimes referred to as invisible items. According to the draft BPM, services are clearly separated from factor incomes and unrequited transfers in the current account.

The classification of services in section III follows the present Standard Components recommended in the fourth edition of BPM because this is the basis of the current practice in the countries discussed here. In the context of the current negotiations on trade in services in the Uruguay Round, factor and non-factor incomes have become the focus of interest. Therefore, the paper deals with the topic not only in the narrow sense but also covers some aspects of factor incomes.

In the context of the current negotiations on trade in services in the Uruguay Round, factor mobility has been considered as a "mode of delivery" for trade in services. Therefore, the paper deals with trade in services not only in the narrow sense, but covers some aspects of factor incomes.

II. STATE OF SERVICE STATISTICS IN ASIA

Since the main information source on international trade in services is the balance of payments (BOP), a questionnaire was sent to various institutions responsible for the compilation of balance-of-payments data in the countries studied here. The questions covered all of the relevant items of the balance-of-payments statistics, but some-

times these proved too general. Most answers stated that the countries followed the BPM recommendations in both principle and practice. The special characteristics of individual countries were identified mainly during personal interviews. BPM recommendations are well-known in most of these countries, and some of the staff members of the visited institutions have taken part in relevant courses of the IMF.

A. Publications on international trade in services

International trade-in-services data are usually published in balance-of-payments tables within the "Invisible items" of the current account. In Hong Kong, these data can be found as a part of the published gross domestic product (GDP) estimation. Monthly data are published in the Republic of Korea, and quarterly data are issued in Thailand, Sri Lanka and India. Yearly data are available in the publications of Hong Kong and Singapore.

The main items published usually follow BPM recommendations. However, there are differences in the level of aggregation (see Annex). The most detailed statistics are issued in Hong Kong. The Republic of Korea and Sri Lanka publish some subdivisions of the main items, while the publications of other countries contain only five or six major items. The balance-of-payments statistics in India are expected to provide more details in the coming years, as the result of a revision process. The new classification follows the IMF draft classification, and will be published in the near future.

B. Data sources and coverage

Trade-in-services statistics are determined to a great extent by the regulatory environment in individual countries. Due to differences in the available data sources, we shall begin with a brief description of exchange control. In this respect, the two extreme options are the following: free systems, such as in Hong Kong and Singapore, and strictly regulated systems, as in the Republic of Korea and India. A trend towards liberalization can be seen even in the strictly regulated countries, as for example in Sri Lanka and Thailand.

The fact that all foreign-exchange transactions are to be conducted through authorized banks means that all receipts from invisibles must be surrendered to one of these banks (or, in some countries, can be deposited in a foreign-currency account in one of these banks) and the only official sources of foreign currencies in order to import payments are also these banks (and the importer's own foreign currency accounts). Tourists are allowed to exchange currencies only at authorized banks or authorized money changers. Due to this exchange-control system, which is applied in Korea, India, Sri Lanka and Thailand, trade-in-services data can be based mainly on foreign-exchange statistics, compiled primarily from detailed information on foreign-exchange transactions reported by the authorized banks and other authorized dealers.

Since the Hong Kong Government follows the economic policy of "positive non-interventionism", there is neither exchange control nor restrictions on capital movements. Data on imports and exports are mostly collected by annual surveys. For some items of services, transaction estimates are based on administrative data. Similarly, surveys serve as the main information sources in Singapore.

For countries which use exchange records as the main data source, statistics covers the entirety of legal transactions conducted in foreign currencies channeled through authorized banks and money changers. Possible omissions come from the fact that a part of international trade in services can be paid in domestic currency. Another possible problem is that the stricter the foreign-currency control, the greater the probability of illegal transactions. Even though statistics seems to be good in respect of both the coverage and the details, some items can be underestimated and some others overestimated, and even the total can be distorted, since illegal transactions cannot be recorded. Countries using exchange records as a basic information source cannot avoid the application of some kinds of sample surveys in order to obtain data, e.g. for the estimation of freight and insurance earnings.

Statistical effects of the liberalization process can sometimes be contradictory. One of the methods of liberalization is to increase the threshold of reporting obligation. It means that on the one hand, the proportion of detailed information decreases, but on the other hand, the motivation for misreporting also decreases at the same time. At the end

of the process, statistical systems must be transformed into survey-based systems but this change is not easy and can be expensive.

In the case of surveys too, the coverage of statistics has some limitations. The frequency and scope of the surveys are limited, they are usually not conducted more frequently than once every year and are sometimes based on stratified samples of establishments. Another type of limitation of data collection is that some producers may not even know whether their clients were residents or non-residents. In Hong Kong, the "Annual survey of imports and exports of services" is obligatorily completed by all establishments engaging in these transactions. In Singapore, data are collected mainly by sample surveys. Selected establishments, which account for more than 80 per cent of the total operating receipts of the service sector, are asked to report on the details (by items) of the amount of their receipts or expenditure originated in Singapore or outside Singapore.

C. Concepts and definitions in practice

With respect to the scope of international trade in services, no deviation has been found from the present BPM. As can be seen in the Annex, the countries in their publications usually follow the IMF recommendations.

The definition of resident unit used for balance-of-payments purposes does not differ significantly from that recommended in SNA and BPM. The embassies, consulates and other government agencies, their personnel and dependents abroad are considered as residents, while foreign embassies, consulates and other government agencies, military units, and their staff with their dependents are considered to be non-residents. Individuals are considered as residents if they have their centre of interest in the country (otherwise, they need to stay longer than one year). Enterprises, even foreign affiliates operating in the country, are usually regarded as residents. Major exceptions are the agencies and in some countries the offshore banking units and agencies which are considered to be non-residents.

It appears, however, that this definition of residency is not applied everywhere consistently. In the countries where the coverage of

balance-of-payments statistics is confined mainly to those transactions that are routed through authorized dealers and money changers, the definition of residency is mainly theoretical, since remittances are classified on the basis of whether they were paid in foreign or domestic currency. All money legally exchanged by non-resident units are registered, but there is no information on transactions conducted in domestic currency. For example, accounts held by foreign embassies in domestic currency in the Republic of Korea, Thailand or Sri Lanka are not treated as foreign liabilities, even though these units are non-residents. Foreign-currency deposits kept in foreign currency are regarded as foreign liabilities, irrespective of whether the depositors are residents or non-residents. In the Indian BOP statistics the data include the transactions of Bhutan with the rest of the world and do not include India's transactions with Nepal because there is no exchange control between the two countries.

Another example of the differences between the concept and the practice is how refugees are considered in the statistics of the countries. There are a number of refugees in some countries of the region. These countries are not the final home for them, since they are not allowed to settle there. In spite of the fact that they intend to settle in another country, they usually spend more than one year in refugee camps waiting for visas. Their statistical treatment is not the same in the different countries. In Hong Kong Vietnamese refugees have to wait for undergoing a screening process to determine their status as such, and thereafter to wait for resettlement in other countries, or otherwise to wait for returning to Vietnam. The whole process takes a long time and nearly all of them actually stay longer than one year. The great majority of them stay in closed camps and are not allowed to work, hence it was a question whether their center of interest can be considered as being in Hong Kong. With various factors taken into consideration (such as the fact that the goods and services they consume as well as their accommodation are covered by the Government of Hong Kong thus their impact on the government budget is significant) they are statistically treated as Hong Kong residents under the one-year residence rule as recommended by the IMF. This problem has not emerged in Thailand even though there too there are a number of refugees in a similar situation. Remittances conducted in Thai Bath are considered to be those between residents, and transactions paid in foreign currency considered

as those between non-residents. In India, refugees a theoretically considered as non-residents, but since the statistics is based on exchange record the practice is similar to the Thai one.

There are some countries, e.g. Thailand, where local students studying abroad are considered to be residents and foreign students are considered non-residents irrespective of the duration of their studies. This practice conforms to the revised SNA recommendation. However, in the case of Thailand, the limitation in the application of the definition mentioned earlier needs to be taken into account. The criterion is one year in Singapore-thus, for example, foreign students studying in Singapore for longer than one year are considered as residents. The remittances conducted by their family are considered as unrequited transfers. A number of foreign students study in India. All of them who stay in the country longer than a year are considered as residents, while Indian students studying abroad for longer than a year are regarded as non-residents.

III. MAJOR FINDINGS BY STANDARD COMPONENTS

A. Shipment

In connection with freight and insurance relating to the exports and the imports of goods, the question arises as to whether the value of freight and insurance should be treated as international trade in services, or should be regarded as part of the value of the goods exported/imported. In this respect, there is a conflict between the present SNA and the present BPM in the valuation of imports. While in the SNA imports are valued on c.i.f. basis, the BPM recommends the f.o.b. basis of valuation. As a result of the process of harmonization between the two recommendations, in the revised SNA, the BPM concept is expected to be adopted.

Imports of goods are usually valued on c.i.f. basis. Balance-of-payments statistics published by IMF contains imports-in-goods data on a c.i.f. basis. Adjustments made in order to exclude freight and insurance on imports reduce the import total to an f.o.b. basis. The amounts of freight and insurance deducted from the c.i.f. value of im-

ports are estimated by the IMF staff in the cases of India, Sri Lanka and Thailand.

A number of different methods are applied in the countries in order to estimate data in connection with international shipment statistics. International transportation survey data are used for the purpose of estimating international freight data in Korea, while insurance data are estimated on the basis of exchange records. Annual survey data serve as the information source for shipping, air transportation and insurance data in Hong Kong. In Thailand, the relevant statistical database is the international bank-transaction record. The total cost of freight and insurance on imports and exports estimated by applying freight-and-insurance factors obtained from sample studies conducted every fifth year in Singapore. The payments to resident carriers (based on the tonnage of inward cargo handled by ships owned by residents in Singapore) is excluded from this total. Shipment-of-exports data are provided by the Shipping Corporation in Sri Lanka, while insurance data are derived from exchange records. In Indian balance-of-payments statistics, freight and insurance earnings on exports are estimated on the basis of a simple random sample, survey using exchange-control forms received from Bombay and Calcutta, conducted by the Reserve Bank of India.

According to the latest IMF proposal for BOP Standard Components, the first item within Services is Transportation. "Transportation" corresponds to the present BPM categories "Shipment" and "Other Transportation" minus merchandise insurance. The following subdivisions are used: Sea, Air and Other transport. Further breakdown is Passenger, Freight and Other transportation.

Shipment is not broken down in the relevant statistical publication of Singapore (see Annex), while it is subdivided into the items of freight and insurance in Thailand and Korea. The classifications applied in Hong Kong and India are quite similar to the new IMF proposals. During the data compilation process further subdivisions are made in some countries. Though these are not published, these can serve as a starting point for the adaptation of the new classification. In Korean statistics, for instance, freight is subdivided into "by air" and "by ship" items. The new BPM publication of India will be more detailed than the present one with respect to the item of transportation.

B. Other transportation

One of the two main items of "Other transportation" is Passenger services". In respect of passenger services, in the statistics of the countries where transportation data are derived from the exchange records, credits usually include remittances received by resident shipping and airline companies from their agents abroad. The services, both within the economy and between economies, are included in BOP only when the accounts are settled in foreign currency. In the case of Thailand, most local expenses of non-resident companies are not counted here because these are deducted from debit of shipment. Debits include remittances made by local agents of foreign companies to their principals abroad. In the case of India, credits also cover remittances received by agents of foreign shipping and airline companies to meet expenses in the country such as port charges, fuels, stores and crews' expenditure, while debits include remittances made by local shipping and airline companies to their agents abroad to meet different expenses and as well as into a third country in order to meet operating expenses occurred there.

The Passenger-services data in Hong Kong and Singapore are derived from relevant surveys. Local branch offices of foreign shipping and airline companies report the details of their activity in the country, as well as the expenses incurred in the country, excluding items not relevant here - e.g. capital expenditures or staff travelling. Resident companies report the amount of passage fares collected outside the country and expenses of local air and shipping lines abroad. This component is an example for limitations mentioned above in relation to not identifying the residency status of clients.

The other main component of "Other transportation" is "Port services, etc." which usually covers mainly port services, e.g. fuel, provisions or cargo handling. But it also includes charters and miscellaneous other services related to the transportation industry. In the Korean BPM, port services are subdivided into port services and charter fees, and payments include deep-sea fishing fees paid by the Korean fishing fleet abroad. Singapore receipts data cover civil mail carried by Singapore Airlines and local shipping lines, while civil mail carried by foreign air and shipping lines is covered by payments data.

Beyond the published breakdown (see Annex), the relevant items in the Korean BOP are subdivided as follows: passenger fares, harbour expenses, operation expenses, charterage and others. An additional subdivision included by payments is deep-sea fishing expenses. In Thai statistics, these unpublished entries, as well as the published items in Sri Lanka are the following: passenger fares, port expenditures and others. In Singapore "Other transportation" is not distinguished as a separate item, which is explained by the fact that there are some industries in Singapore which have only one or few enterprises, as for example the Singapore Airlines. In the present BOP publication of India, "Other transportation" as such is not distinguished as a separate item. However, the new classification is expected to be more sophisticated in this respect. Breakdown of statistical data published by Hong Kong are detailed enough to provide sufficient information on the topic.

C. Travel

The credit entries under the item "Travel" in BPM covers all goods and services acquired from the reporting country by travellers during their stay. The international carriage of travellers is covered in "Passenger services" rather than in this component. According to BPM, "a traveller is a person staying for less than one year in an economy of which he is not resident, for any purpose other than (a) being stationed on a military base or with another government agency of his own government ... (b) accompanying a person mentioned under (a) as a dependent, (c) or undertaking a product activity directly for an entity which is a resident of that economy." Entries related to the exceptions mentioned under (a), (b) and (c) are appropriate to the item "Other goods, services and income".

Due to the definition mentioned above, the borderline between goods and services is different for international and domestic transactions. According to an IMF/UNSO survey conducted at the end of 1987, more than the half of the 66 countries which responded thought that the distinction between goods and services should be the same in recording international transactions as it is in the treatment of domestic transactions. One-fourth of the countries, while recognizing the usefulness of having the same services concept used in domestic and external transactions, considered for various reasons that there should be

some flexibility in this regard. Eleven countries felt that this approach was either not necessary or hardly feasible.

Although the approach can be considered as having only theoretical importance, statistical data prove that shopping is one of the most important visitor-expenditure categories in some countries. The proportion of shopping within the total visitor spending was: more than 50 per cent in Hong Kong in 1989 and 1990, almost 40 per cent in Thailand in 1988 and 1989, and almost 65 per cent in Singapore in 1988 and 1989.

Republic of Korea and Sri Lanka responded that it was desirable to adopt the same borderline in both domestic and international statistics. The reply of Thailand was definite "no". Singapore, Hong Kong and India considered it to be desirable that the distinction between goods and services should be broadly the same for both international and domestic transactions. However, all these countries stressed that it was desirable only from a conceptual point of view, and they considered some exceptions to be unavoidable. A typical example of such exceptions was the concept of "travel".

In spite of the differences in the answers of different countries, the definitions used for preparing the data are broadly consistent with the BPM definition. Most of the deviation is usually due to the limitations of the statistical systems applied in the countries. Basic data for debit estimations are usually derived from immigaration statistics or exchange-record data. Credit-data estimations are based on representative sample surveys in Hong Kong, Thailand, Singapore and Sri Lanka, while in India and Thailand these are derived from the exchange records. Although the main information source for BOP data estimation are the exchange records in Thailand and Sri Lanka, these cannot provide sufficient information on tourism, partly because exchange records reflect only the remittances and currency exchanges that are channelled through authorized dealers. Liberalization of exchange control regulation is another reason why exchange records cannot serve as appropriate data source, since less and less information is available on that segment of transaction which contains tourism. Since tourism is one of the most important economic factors in these countries, there is a need to obtain more precise and detailed information on this activ-

ity than are available from exchange records. In India, a survey was conducted in order to classify the "Unclassified receipts", i.e. receipts which are individually equivalent to or less than IRs 10,000.

In the Korean BPM, the entries of both credits and debits are based on the exchange records, and the Bank of Korea does not have any other source of information on tourism. This means that the data represent the conversion of foreign exchange into Won by foreign travellers in the country and foreign-exchange purchases from the banking system by Korean travellers, respectively. No other data source is used for this purpose.

Tourism is very important for Hong Kong - the number of tourists that arrived in 1990 was equal to the total population. Export data are based on visitor survey conducted by the Hong Kong Tourist Association. The publication entitled *Tourism Receipts* contains detailed data on visitors, such as: their spending by major market areas (South-East Asia, Taiwan, Japan, United States/Canada, Western Europe, Australia/New Zealand, and other) and expenditure categories (shopping, hotel bills, meals out, entertainment, tours, and other).

Tourism is also important for Thailand. Credit data represent receipts from tourists and other visitors to the country. Dàta are derived from the *Annual Statistical Report on Tourism in Thailand*, published by the Tourism Authority of Thailand. This publication covers data on tourists visiting the country as well as on outgoing travellers. According to the applied definition, visitors are considered as tourists if the purpose of their visit can be classified under one of the following: leisure, business, family, mission and meeting, and if they stay longer than 24 hours but not longer than 60 days. Tourists are classified by both nationality and country of residence. Data are collected from embarkation/disembarkation cards of the Immigration Division. The length of stay is calculated by random sampling of one-third of the total figures of tourists. Tourist profiles (e.g. sex, age, and purpose of visit) are calculated by random sampling based on one-tenth of the total number. Tourist-expenditure data cover both revenues and expenditures. The source of revenue data is the International Visitor's Expenditure Survey usually conducted every alternate year using sampling survey methods. Face-to-face interviews were employed to the sample size of 10,000 tourists. Expenditure data

are derived from the bank record. Visitor-expnditure data are published among others by expenditure categories such as accommodation, food and drink, shopping, entertainment, local transport and tours, and miscellaneous.

In 1989, Singapore welcomed a total of more than four million visitor arrivals, while the total of population was about 2.5 million people. Debit-data estimations are based on migration statistics. Credit data of Singapore are based on both migration data and information derived from Survey of Overseas Visitors to Singapore conducted by Singapore Tourist Promotion Board. The above-mentioned survey is based on personal interviews with departing visitors conducted every day in five languages. Disproportionate stratified sampling was employed in respondent selection. A total of more than 10,000 visitors departing by air were interviewed. The publication on the survey contains detailed cross tables by several characteristics of visitors, such as visitor profile (e.g. country, sex, income), travel pattern (e.g. main purpose, duration), visit experience and visitor expenditure. Detailed figures of visitor expenditure cover data on expenditure profile and total visitor expenditure e.g. expenditure pattern by country of residence and by items purchased (such as accommodation, food and beverage, shopping, sightseeing, local transportation, entertainment and recreation, and miscellaneous).

According to the *Balance-of-Payments Statistics* published by IMF, credit data on the item "Travel" are derived from surveys of tourist expenditures, and may include purchases of gems for commercial purposes by visiting traders (appropriate to the item "Merchandise") in Sri Lanka. Debit entries are exchange-record data on sales of foreign exchange to residents for travel and studying abroad. Since the threshold of reporting obligation at currency exchange is $500, all transactions below that amount are considered to be appropriate to the item "Travel".

According to the BPM issued by Reserve Bank of India, "Travel" credits in India's BOP statistics cover the following items:

- Receipts in foreign exchange in amounts individually equivalent of IRs 10,000 and above, and reported as travel receipts by au-

thorized dealers. These represent remittances received from organizers of foreign tourist parties located abroad for meeting their hotel and other expenses in India and funds received from abroad for meeting the expenditure of foreign students enrolled in Indian educational institutions.

- "Unclassified" receipts, that is, purchases of foreign exchange by authorized dealers in amounts individually equivalent to less than IRs 10,000 and allocated to "Travel" on the basis of the result of the Survey of Unclassified Receipts.

- Foreign tourists' expenditure in India financed from rupee balances maintained by the United States Embassy in India with the Reserve Bank of India.

The total travel credits, as recorded in the BOP, do not provide a detailed purpose-wise classification of the expenditure incurred by foreign travellers during their visits to India. In contrast, the data on "travel debits" provide a detailed classification of the foreign exchange sold to residents for travel abroad. These cover sales of foreign exchange for the following purposes: business, expenses of Indians studying abroad or receiving training abroad, official business travel, Haj Pilgrimage, health reasons, home-leave salary, and sales to tourists and others. Travel debits exclude remittances made by foreign nationals in India for meeting the educational expenses of their children abroad and for correspondence courses overseas. These are covered under private transfer payments.

The published BOP statistics do not contain any breakdown of the item "Travel", except in Hong Kong where the subdivisions are the following: expenditure of civilians visitors, service visitors, transit passengers and foreign crews. In the published Thai statistics, "Travel" is broken down as tourists, business, students, government and others. In spite of the very detailed survey, the data breakdown of "Travel" is not published in Singapore, and separate estimations are made for the following receipt entries: visitors and visitors in transit, full-cruise passengers, Malaysian citizens, group tour visitors, transit passengers, airport tax, tourists' shopping in Singapore, and foreign air and sea crew expenditure in Singapore. Payments (estimated expenditure abroad) are subdivided as follows: returning residents abroad (except Malaysia),

returning residents from Malaysia, local seamen and SIA crew. As mentioned earlier, in the Indian BOP, total travel credits do not provide a detailed purpose-wise classification of the expenditure incurred by foreign travellers during their visits to India. In contrast, the data on "travel debits" provide a detailed classification of the foreign exchange sold to residents for travel abroad. These cover sales of foreign exchange for the following purposes: business, expenses of Indians studying abroad or receiving training abroad, official business travel, Haj pilgrimage, health reasons, home-leave salary and sales to tourists and others.

D. Government services

The definitions underlying Government-services (Official- transactions) data broadly correspond to the definition given in paras. 310-318 of the BPM: they usually cover transactions both of the resident government with foreigners and of foreign governments with residents of the compiling economy. Typical data sources are government accounts, exchange records and other governments.

In the Korean BOP statistics, Government services receipts data are derived from the exchange record and these are subdivided in the following way: Military transactions (receipts from the United Nations force, goods and services, others) and non-military transactions (items of payments are the following: technical assistance, expenditures by embassies and consulates, other payments).

In Hong Kong, the item "Expenditure of employees of extraterritorial bodies and their dependents in Hong Kong" is estimated on the basis of the number of embassies and their employees. "Government expenditure abroad" data are derived from the Government accounts. Sources of government services data are the exchange records in Thailand. Subdivisions are "Military" and "Non-military" services. Military services cover transactions between the United States military base and Thai residents, but detailed information is not available on them. In the case of Singapore, entries on foreign consulates and embassies are obtained from the partner countries, and defence-services data include receipts from British, Australian, Malaysian and New Zealand armed forces stationed in Singapore. Debit data are derived

from government accounts. Both credit and debit data are taken from exchange records in Sri Lanka. These include some entries which were appropriate to unrequited transfers, such as pensions paid by the Sri Lankan Government and received from foreign governments, or contributions to international organizations by Sri Lanka. In India credit entries mainly comprise funds received from foreign governments for the maintenance of their embassies, consulates and diplomatic missions stationed in India, and from international and regional institutions for the maintenance of their offices in India. Entries which are not appropriate here are deducted from gross receipts. Debit entries cover mainly remittances made by the Government of India for the maintenance of Indian embassies and diplomatic missions abroad.

E. Other private services

Other private services are negatively defined as all service transactions that are not specifically allocated to other items. Since the importance of these services has grown, the draft list of BOP Standard Components classifies a number of them as a major items, putting them at the same level as "Travel" and "Transportation". Definitions applied in the visited countries are broadly consistent with the relevant definitions of BPM. There are some entries which seem to be difficult to classify, such as processing, repairs and computer-related services. There are some differences among countries with respect to the classification of private services.

In the Republic of Korea, "Other private services" are broken down into the following items: Construction services, Branch expenditures, Consulting services, Royalties, Advertising, Communication services, Computer services, and Others. Most data are derived from the exchange records. Construction services are considered as a separate item due to the relative importance of this activity.

In the published statistics in Hong Kong, the classification is the following: Insurance, Production and distribution of films/programs, Hotel management, Advertising and marketing research, News transmission, Financial assets dealing and broking, Adjustment for import shipment, and Banking services. Data are obtained from surveys. Since Hong Kong is one of the most important financial centres of the world,

related data also have great importance. A sophisticated method was developed in order to obtain relevant information without risking the disclosure of confidential information supplied by individual banks. Hong Kong also serves as a bridge between China and the rest of the world. This is why the classification of processing activity as merchandise or service transactions has a great influence on statistical data. Though processing is registered as merchandise trade in each visited country, in the case of Hong Kong the issue has particularly important implications on the in the case of Hong the issue has particularly important implications on the interpretation of merchandise statistics since processing trade accounts for a significant proportion of its external trade. Deviation from this approach may represent significant disharmonization with external trade statistics which are separately published. Besides, there are practical difficulties with data compiliation. So processing activity is treated as merchandise, included in both import and export entries counted on gross basis.

Other private services are classified in the following way in Thailand: Insurance, Re-insurance, Management fees, Agents' fees, Construction activity, Advertising, Subscription to press, Film rentals, Copyright and patent royalties, and Others. Data are based on exchange records. Though processing is an important activity in Thailand - consisting mainly of gem processing - services do not cover it, even in the case of minor alteration.

In Singapore, "Other private services" are subdivided into the following items: Non-merchandise insurance, Agency fees and commissions, Management fees, Communication, Film rental, Bank service charges, Medical expenses of foreigners in Singapore, and Stock brokerage fees. Data are derived from surveys and from the census of industrial production. Petroleum processing is an important activity in Singapore, but it is covered by merchandise statistics. Due to the growing role of Singapore as an international stock exchange, stockbrokerage fees are classified as a separate item.

In the published BOP of Sri Lanka, there are only the following two subdivisions: Non-merchandise insurance and Others. In the latest Indian BOP publication, Other private services are not broken down.

However, according to more recent information, the revised BOP publication will contain detailed data on private services.

With respect to the borderline problems mentioned earlier, the country practices are the following:

- Any kind of processing abroad is in all the countries covered by merchandise trade, and there is no distinction between processing resulting in minor and in major alterations.

- Repairs of capital goods, similar to all the other kinds of repairs abroad, is usually counted as services. The only exception is Hong Kong, where there is no data compilation on this activity.

- Construction abroad is considered to be part of services in Hong Kong, Korea, Sri Lanka and Thailand, irrespective of the duration of works. In India, it is covered by merchandise trade, and in Singapore there is no data compilation on this activity.

- Installation abroad is one of the entries of merchandise trade in India. In the Republic of Korea, Sri Lanka and Thailand, this activity is considered as a service. The other countries do not collect data on that item.

- Operational leasing is covered by services in each country. Financial leasing is treated as merchandise trade in the Republic of Korea, Sri Lanka and Thailand, while it is recorded as a service in Singapore and India.

- Author fees, copyrights, license fees and franchising are included in services and not in property incomes in all the countries where data for these activities are compiled. In Singapore author fees, and in Hong Kong copyrights of films, television and video programmes are the only data collected. In India, there is no statistical information collected on franchising.

F. Incomes and unrequited transfers

In the draft BOP Standard Components, incomes and unrequited transfers are clearly separated from services. In spite of this fact, since the present BPM recommendations are the ones which are followed by

most of the visited countries, incomes are not differentiated sharply from services in their practice.

Concerning investment incomes, countries usually follow the definition given in BPM. Hong Kong does not compile the full set of balance of payments statistics and statistics on investment income are not available. Besides, there are also no official data published related to capital movements. In the Republic of Korea, Thailand, Sri Lanka and India, data are mainly derived from exchange records. Reinvested earnings data are obtained from official sources in Korea where investment incomes are composed of dividends, interests on loans, interests on bank loans, interests on deposits, reinvested incomes and others. In Thailand, the subdivisions applied are the following: Interest, Profit, Dividends and Others, while in Sri Lanka they are: Direct investments and Others. In India, companies with more than 40 per cent of equity owned by non-residents are defined as direct investment companies. If 25 per cent of equity is owned by one particular country, the company is also considered to be a direct investment company. In the case of hotels and hospitals, the threshold is 60 per cent. In Singapore, companies with more than 20 per cent of equity owned by non-residents are defined as direct investment companies. Data are derived from surveys of enterprises, banks and finance companies, insurance companies and statutory boards. Data related to the Government are obtained from the Singapore Currency Board and the Monetary Authority of Singapore.

Labour incomes and Unrequited transfers are observed regularly in the Republic of Korea. Data are basically derived from exchange records, but unrequited transfers are recorded on the basis of outcome data for non-commercial trade. Components of Unrequited transfers are classified as Private and Official transfers. Donations including workers' remittances and non-commercial imports including migrants' transfers are the subdivisions of the former item, while the latter contains Taxes, Technical assistance and Other data. Hong Kong does not publish data on these items. In Thailand, Labour income is classified as the part of Other Services. Unrequited transfers contain Government transfers and Private transfers (Migrants and Others). The main data source is exchange records. In Singapore, labour-income data are obtained from surveys. Border workers' income is not recorded here.

Malaysian citizens from across the causeway are considered as residents. Unrequited transfers data are derived partly from immigration records on transfers (migrants' transfers) and partly from government accounts (intergovernment transfers). In India and Sri Lanka, the data are based on both exchange records and government accounts. Unrequited transfers are subdivided into Private and Official transfers.

ANNEX

ITEMS OF TRADE IN SERVICES STATISTICS PUBLISHED

1. Republic of Korea

Monthly balance-of-payments statistics are published by the Bank of Korea in both Korean and English. The title of chapter 2 is "Service and Unrequited transfers". Relevant subdivisions are the following:

Credits:

Shipment:	Freight, Insurance
Other Transportation:	Passenger fares, Port services, Charter of Carriers, Travel,
Investment of Income:	Interest on time deposits

Other:	Government transactions,
	Miscellaneous services:
	    Construction,
	    Branch expenditures
	Non-merchandise insurance

Debits: almost similar breakdown with the following different item: Investment Income: Interest on loans: Interest on bank loans

2. Hong Kong

Since balance-of-payments statistics are not compiled, trade in services data can be found in "Estimates of Gross Domestic Product" issued by Census and Statistics Department in English every year. Table 7 "Composition of Imports and Exports of Goods and Services" contains the following data:

A. Export of services:

1. Transportation:	
Shipping:	Cargo revenue Passenger revenue Chartering revenue Management and agency fees Foreign companies disbursement in Hong Kong excluding expenditure on fuel oils and port charges
Air transportation:	Cargo and passenger revenue and fees and commission received from foreign companies, disbursements of foreign companies excl. exp. on fuel oils and port charges
Expenditure in Hong Kong of foreign airline and shippig companies on:	Fuel oils Port and airport charges
Cargo forwarding	
2. Travel:	Expenditure of civilian visitors in Hong Kong Expenditure of service visitors in Hong Kong Expenditure of transit passengers in Hong Kong

	Expenditure of foreign crews in in Hong Kong
3. Insurance:	Direct insurance to overseas Re-insurance assumed from overseas Agents' commission
4. Production and distribution of films/programmes	
5. Hotel management	
6. Advertising and marketing research	
7. News transmission	
8. Financial assets dealing and broking	
9. Adjustment for import shipment	
10. Banking services	
11. Other services:	Expenditure of employees of extra-territorial bodies and their dependents in Hong Kong Postal services Miscellaneous services n.i.s.
B. Imports of services	
1. Transportation:	
Shipping:	Charter hire
Shipping and air transportation:	Disbursement of Hong Kong companies abroad Other revenue of foreign companies in Hong Kong Passenger fares
2. Travel:	Expenditure of Hong Kong residents abroad Expenditure of Hong Kong students abroad

3. Insurance: Direct insurance from overseas
Re-insurance ceded overseas
Expenses of local insurance companies abroad

4-8. Similar to items of Exports of services respectively

9. Banking services

10. Other Services: Government expenditure abroad
Postal services
Miscellaneous services

3. Thailand

Quarterly Bulletin published by the Bank of Thailand in English contains balance of payments. Relevant items are the following:

Services:

1. Receipts:
   1.1 Freight and insurance on merchandise
   1.2 Other transportation
   1.3 Travel
   1.4 Investment income
   1.5 Government, n.i.s.: military services
   other government services
   1.6 Other services

2. Payments: Breakdown is similar to one of Receipts

4. Singapore

Most of the balance-of-payments data are published yearly in "Economic Survey of Singapore" in English. The breakdown of exports and imports is the following:

Shipment
Travel
Investment income
Official transaction
Other transportation and services n.i.e.

5. Sri Lanka

Bulletin of Central Bank of Sri Lanka issued by the Department of Economic Research in English contains quarterly balance-of-payments data. Relevant items of both credits and debits in the current account are the following:

3. Freight and Merchandise Insurance

4. Other Transportation
   4.1. Passenger fares
   4.2. Port expenditures
   4.3. Other

5. Travel

6. Investment income
   6.1. Direct investment
   6.2. Other

7. Government Expenditure n.i.e.

8. Other Services
   8.1. Non-merchandise Insurance
   8.2. Other

6. India

The Reserve Bank of India Bulletin is a bilingual publication. The data include the transactions of Bhutan with the rest of the world and do not include India's transactions with Nepal because there is no exchange control between the Nepal and India. The following quarterly data are published in Indian Rupees:

Credits and Debits:

1. Travel
2. Transportation
3. Insurance
4. Investment Income
5. Government, not included elswhere
6. Miscellaneous

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